



# Legislative Audit Division

State of Montana

Report to the Legislature

December 2006

## Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2006

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## Board of Investments

Department of Commerce

We performed a financial-compliance audit of the Board of Investments for the two fiscal years ended June 30, 2006. This report contains the audited financial statements and accompanying notes for the two fiscal years 2005-06 and 2004-05. We issued unqualified opinions on the financial statements of the Board of Investments' Retirement Funds Bond Pool, Trust Funds Bond Pool, Short Term Investment Pool, Montana Domestic Equity Pool, Montana International Equity Pool, Montana Real Estate Pool, Montana Private Equity Pool, All Other Funds, and Enterprise Fund.

This report contains no recommendations.

Direct comments/inquiries to:  
Legislative Audit Division  
Room 160, State Capitol  
PO Box 201705  
Helena MT 59620-1705

06-04

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## FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2007, will be issued by March 31, 2008. The Single Audit Report for the two fiscal years ended June 30, 2005, was issued on March 6, 2006. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator  
Office of Budget and Program Planning  
State Capitol  
Helena MT 59620  
Phone (406) 444-3616

Legislative Audit Division  
Room 160, State Capitol  
PO Box 201705  
Helena MT 59620-1705

### MEMBERS OF THE LEGISLATIVE AUDIT COMMITTEE

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# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

December 2006

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial-compliance audit report on the Board of Investments for the two fiscal years ended June 30, 2006. We performed the audit of the Board of Investments in compliance with Article VIII, section 13 of the Montana Constitution, and section 17-6-321; MCA. The objectives of our financial-compliance audit included determining if the board's financial statements presented fairly its financial position and results of operations for each of the two fiscal years ending June 30, 2006; determining the board's compliance with applicable laws and regulations; and obtaining an understanding of the board's control systems and, where appropriate, making recommendations for improvement.

The Board of Investments, originally created in 1971, is attached to the Department of Commerce for administrative purposes. The board employs an executive director and chief investment officer who in turn hire and manage board staff. The staff members advise the board, implement its decisions, and perform daily investment, economic development, and record keeping functions. Included in this report is a list of the board members of the Board of Investments and administrative officials (page i).

This report contains unqualified Independent Auditor's Reports for each of the following nine sets of financial statements of the Board of Investments (page A-1): Retirement Funds Bond Pool, Trust Funds Bond Pool, Short Term Investment Pool, Montana Domestic Equity Pool, Montana International Equity Pool, Montana Real Estate Pool, Montana Private Equity Pool, All Other Funds, and Enterprise Fund. The board's response to this report is on page C-1.

This report does not contain any recommendations to the board. The prior financial audit report, issued for the fiscal year ended June 30, 2005, did not contain any recommendations to the board.

We thank the members of the Board of Investments and staff for their cooperation and assistance during the audit.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Scott A. Seacat", written over a horizontal line.  
Scott A. Seacat  
Legislative Auditor



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## Appointed and Administrative Officials

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### Montana Board of Investments

|                       |             | Term<br><u>Expires</u> |
|-----------------------|-------------|------------------------|
| Terry Moore, Chairman | Billings    | 1/2007                 |
| Elouise Cobell        | Browning    | 1/2009                 |
| Teresa Cohea          | Helena      | 1/2007                 |
| Karen Fagg            | Billings    | 1/2007                 |
| Maureen Fleming       | Missoula    | 1/2007                 |
| John Paull            | Butte       | 1/2009                 |
| Jack Prothero         | Great Falls | 1/2009                 |
| Jim Turcotte          | Helena      | 1/2009                 |
| Calvin Wilson         | Busby       | 1/2007                 |

### Administrative Officials

Carroll South, Executive Director

Geri Burton, Deputy Director

Cliff Sheets, Chief Investment Officer

Gayle L. Moon, Accounting Fiscal Manager

For further information on the Montana Board of Investments  
contact Carroll South, Executive Director, at:

PO Box 200126  
Helena MT 59620-0126  
(406) 444-0001  
e-mail: [csouth@mt.gov](mailto:csouth@mt.gov)

Members of the audit staff involved in this audit were Laurie Barrett,  
John Fine, Paul J. O'Loughlin, Vickie Rauser, and Jeff Tamblyn.



# Financial Statements Index

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# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Retirement Funds Bond Pool, as of June 30, 2006, and 2005, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Retirement Funds Bond Pool, as of June 30, 2006, and 2005, and its changes in net asset value and investment income and distribution for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in black ink that reads "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
RETIREMENT FUNDS BOND POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2006 AND 2005

|                                                                                                                             | <u>2006</u>             | <u>2005</u>             |
|-----------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| <u>Assets</u>                                                                                                               |                         |                         |
| Cash                                                                                                                        | \$ 0                    | \$ 0                    |
| Security lending cash collateral (Notes 3 and 4 )                                                                           | 84,096,961              | 214,242,953             |
| Interest receivable                                                                                                         | 22,517,028              | 21,273,507              |
| Investments managed at fair value (amortized cost of \$1,852,698,544 in 2006 and \$1,752,825,241 in 2005)(Notes 2, 4 and 8) | <u>1,837,044,446</u>    | <u>1,836,304,371</u>    |
| Total assets                                                                                                                | \$ <u>1,943,658,435</u> | \$ <u>2,071,820,831</u> |
| <u>Liabilities</u>                                                                                                          |                         |                         |
| Income due participants (Note 2)                                                                                            | \$ 10,412,546           | \$ 10,375,342           |
| Broker payable for securities purchased but not settled (Note 2)                                                            | 0                       | 12,000,000              |
| Security lending obligations (Notes 3 and 4)                                                                                | 84,096,961              | 214,242,953             |
| Security lending expense payable                                                                                            | <u>461,928</u>          | <u>582,309</u>          |
| Total liabilities                                                                                                           | <u>94,971,435</u>       | <u>237,200,604</u>      |
| Net asset value                                                                                                             | \$ <u>1,848,687,000</u> | \$ <u>1,834,620,227</u> |
| Units Outstanding (Note 2)                                                                                                  | 18,521,148              | 17,421,903              |
| Unit Value (Note 2)                                                                                                         | \$ 99.81                | \$ 105.31               |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                              |                         |                         |
|----------------------------------------------|-------------------------|-------------------------|
| Net asset value, beginning of year           | \$ 1,834,620,227        | \$ 1,599,757,622        |
| Value of units purchased by participants     | 113,200,000             | 219,000,000             |
| Value of units sold by participants          | 0                       | 0                       |
| Changes in fair value of investments managed | <u>(99,133,227)</u>     | <u>15,862,605</u>       |
| Net asset value, end of year                 | \$ <u>1,848,687,000</u> | \$ <u>1,834,620,227</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                               |                      |                      |
|-----------------------------------------------|----------------------|----------------------|
| Interest income (Note 2 )                     | \$ 95,623,643        | \$ 90,313,722        |
| Amortization/accretion                        | 9,000,201            | 7,120,260            |
| Net realized gains                            | 693,578              | 21,186,265           |
| Security lending income                       | 7,260,703            | 4,491,649            |
| Security lending expense                      | (7,156,959)          | (4,284,986)          |
| Administrative expenses                       | (340,187)            | (233,417)            |
| Income due participants, beginning of year    | <u>10,375,342</u>    | <u>11,798,842</u>    |
| Income available for distribution             | 115,456,321          | 130,392,335          |
| Distribution                                  | <u>105,043,775</u>   | <u>120,016,993</u>   |
| Income due participants, end of year (Note 2) | \$ <u>10,412,546</u> | \$ <u>10,375,342</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
RETIREMENT FUNDS BOND POOL

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2006 AND 2005

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Retirement Funds Bond Pool (RFBP) was created by the Board to allow qualifying funds, per section 17-6-201, MCA, to participate in a diversified pool. The RFBP was created on April 1, 1995, by the transfer of all fixed income and variable-rate securities owned by the state's nine retirement funds.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

RFBP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The RFBP portfolio includes securities classified as corporate, foreign government bonds, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

The RFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Some RFBP REMICs are interest-only strips (IOs). Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. IOs receive cash flow from the interest payment component on underlying mortgage loans. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as U.S. government indirect-backed in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 8 for the Year End Portfolio.)

RFBP fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The RFBP variable-rate securities float with LIBOR (London Interbank Offered Rate) or the weighted average of the net mortgage interest rates for the mortgage loan group. The variable-rate securities, with a total amortized cost of \$87,000,003 for seven securities and \$52,000,003 for six securities, respectively, as of June 30, 2006 and 2005, are identified and reported as corporate or U.S. government indirect-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 8 for the Year End Portfolio.)

The RFBP, as an internal investment pool, invests its excess cash in the Board's Short Term Investment Pool (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

Investments are presented in the Statement of Net Asset Value at fair value. Fair values are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

Participant Units

The Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds transferred all fixed income and variable-rate securities, at amortized cost, into the RFBP at the start-up date and were issued units according to the market value of each participant's portfolio. The initial unit value as of April 1, 1995, was \$100.00. Unit values thereafter are calculated weekly and at month end, based on portfolio pricing, to allow for participant transactions to occur as determined by the investment staff.

The June 30, 2006 unit value of \$99.81 decreased from a June 30, 2005 unit value of \$105.31. The yield on longer term bonds increased during the fiscal year, which has the effect of decreasing bond prices and the pool unit value. A one percent (1%) change in interest rates is expected to have a three to five percent (3%-5%) inverse change in the unit

value. RFBP investments are considered long-term in nature.

The Value of Units Purchased by Participants of \$113.2 million for fiscal year 2006, as compared to \$219 million purchased for fiscal year 2005, reflects the pension funds' portfolio rebalancing. RFBP units were purchased to adjust the pension funds' portfolio towards the stated equity/fixed income asset allocation.

#### Broker Receivable/Payable

RFBP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the RFBP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

#### Other

Accumulated income, recorded as Income Due Participants, is distributed monthly on the first calendar day of each month. Realized portfolio gains/losses are distributed at least annually to the participants.

Interest income reported in the Statement of Investment Income and Distribution includes interest accruals and miscellaneous income.

Administrative expenses incurred by the Board are charged daily to RFBP based on the Board's expenses applicable to RFBP. These expenses include costs for the custodial bank contract.

### 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 102 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2006, the carrying and fair values of the underlying securities on loan for the RFBP were \$82,091,292 and \$81,700,961 respectively. The collateral provided for the securities on loan totaled \$84,096,961 in cash and \$381,000 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$15,809,696 corporate, \$109,264 foreign government bonds, and \$66,172,332 U.S. government indirect-backed bonds.

As of June 30, 2005, the carrying and fair values of the underlying securities on loan for the RFBP were \$199,141,164 and \$208,000,643 respectively. Cash collateral provided for the securities on loan totaled \$214,242,953. The carrying value of the underlying securities on loan is categorized as \$29,436,384 corporate, \$114,129 foreign government bonds, \$102,991,211 U.S. government direct-backed bonds and \$66,599,440 U.S. government indirect-backed bonds.

### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the

following paragraphs.

### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the RFBP fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires RFBP fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the table below are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, all the fixed income securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The State Street repurchase agreement was purchased in the State of Montana Board of Investments name.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement. According to the RFBP Investment Policy, "with the exception of U.S. government indirect-backed (agency) securities, additional RFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". The RFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 5.50% as of June 30, 2006 and 6.21% as of June 30, 2005.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The RFBP investment policy does not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs and ARM's)."

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

As reported in the U.S. government indirect-backed category, the RFBP portfolio holds REMICs totaling \$387,052 and \$554,309 in amortized cost, respectively, as of June 30, 2006 and June 30, 2005. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

The Interest Only (IO) securities are more sensitive to prepayments by mortgagees resulting from interest rate changes than other REMIC securities. The IO REMIC securities purchased in August and September 1992 carry an amortized cost of \$3 as of June 30, 2006 and June 30, 2005.

The RFBP holds one inverse variable rate corporate \$25 million par bond. The quarterly coupon is calculated at an increased set rate less the 12 month LIBOR in arrears. As interest rates increase, the coupon paid will decline.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2006 and June 30, 2005. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

**Credit Quality Rating and Effective Duration as of June 30, 2006**

| <u>Security Investment Type</u>               |    | <u>Fair Value</u>    | <u>Credit<br/>Quality<br/>Rating</u> | <u>Effective<br/>Duration</u> |
|-----------------------------------------------|----|----------------------|--------------------------------------|-------------------------------|
| Corporate Bonds (Rated)                       | \$ | 930,859,199          | A                                    | 5.20                          |
| Corporate Bonds (Unrated)                     |    | 13,928,888           | NR                                   | 3.81                          |
| Foreign Government Bonds                      |    | 4,850,000            | BBB                                  | 5.83                          |
| U.S. Government Direct-Backed                 |    | 55,508,068           | AAA                                  | 6.87                          |
| U.S. Government Indirect-Backed               |    | 722,333,929          | AAA                                  | 4.73                          |
| State Street Repurchase Agreement* (Rated)    |    | 447,861              | AA-                                  | NA                            |
| Short Term Investment Pool (STIP)             |    | <u>109,116,501</u>   | <u>NR</u>                            | <u>NA</u>                     |
| Total Fixed Income Investments                | \$ | <u>1,837,044,446</u> | <u>AA-</u>                           | <u>5.05</u>                   |
| Securities Lending Collateral Investment Pool | \$ | <u>84,096,961</u>    | NR                                   | NA                            |

\* At June 30, 2006, the State Street Bank repurchase agreement was collateralized at \$449,375 by a AAA rated Federal National Mortgage Association note maturing May 15, 2008.

**Credit Quality Rating and Effective Duration as of June 30, 2005**

| <u>Security Investment Type</u>               |    | <u>Fair Value</u>    | <u>Credit<br/>Quality<br/>Rating</u> | <u>Effective<br/>Duration</u> |
|-----------------------------------------------|----|----------------------|--------------------------------------|-------------------------------|
| Corporate Bonds (Rated)                       | \$ | 894,556,479          | A-                                   | 5.75                          |
| Corporate Bonds (Unrated)                     |    | 19,537,653           | NR                                   | 4.07                          |
| Foreign Government Bonds                      |    | 5,217,500            | BBB                                  | 6.67                          |
| U.S. Government Direct-Backed                 |    | 188,790,314          | AAA                                  | 4.50                          |
| U.S. Government Indirect-Backed               |    | 605,800,830          | AAA                                  | 3.91                          |
| State Street Repurchase Agreement* (Rated)    |    | 9,923,600            | AA-                                  | NA                            |
| Short Term Investment Pool (STIP)             |    | <u>112,477,995</u>   | <u>NR</u>                            | <u>NA</u>                     |
| Total Fixed Income Investments                | \$ | <u>1,836,304,371</u> | <u>AA-</u>                           | <u>4.95</u>                   |
| Securities Lending Collateral Investment Pool | \$ | <u>214,242,953</u>   | NR                                   | NA                            |

\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at \$10,169,671 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

**Specific Legal and Credit Risk**

As of June 30, 2006 and June 30, 2005, Northwest Airlines Inc. presented a higher credit risk to the Board. The RFBP held a \$5,745,000 par 4.64% Northwest Airlines Inc. real estate backed bond maturing July 7, 2010. This bond, with a June 30, 2006 and 2005 book value of \$5,745,000 is secured by Northwest Airlines Inc.'s corporate headquarters building and land.

As of June 30, 2005 the RFBP held a \$9,930,036 par 6.81% Northwest Airlines Inc. bond maturing February 1, 2020 and a \$7,802,614 par 7.935% Northwest Airlines Inc. MBIA Insurance Corp. insured bond maturing April 1, 2019. The combined book value of these two securities was \$17,244,339 as of June 30, 2005. On September 14, 2005, the company filed for Chapter 11 bankruptcy protection. Due to this action, the Board stopped the interest income accruals for the 6.81% bond maturing February 1, 2020 after the August 2005 pay date. This issue was sold on September 20, 2005 generating a loss of \$642,183. The sale included accrued interest from August 1, 2005 to September 20, 2005. Since the 7.935% bond maturing April 1, 2019 is insured by MBIA Insurance Corp. to support the payment of any interest due and outstanding principal balance, the Board did not stop the interest income accrual or reduce book value. On January 11, 2006 Northwest Airlines Inc. called the 7.935% bond maturing April 1, 2019 at par and included accrued interest from October 1, 2005 to January 11, 2006. The Board recorded a gain of \$132,710 on this transaction.

As of June 30, 2006 and June 30, 2005, Burlington Industries, Inc. presented a legal and higher credit risk to the Board. The Board owns a Burlington Industries, Inc., \$6 million par, 7.25% bond maturing September 15, 2005. In September 2000, the company announced a reduction of stockholders equity. Due to an increasing senior bank line and declining credit trend, the bond ratings for this issue were downgraded, in May 2001, by the Moody's and Standard & Poor's rating agencies. During fiscal year 2001, the book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of \$5,609,640 to \$2,400,000. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to \$1,200,000. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the Board received \$1,454,961 in August 2004 for its unsecured claim. This transaction reduced the book value to \$0 and generated a gain of \$254,961. In February 2005 and May 2005, the Board received an additional \$208,771 and \$194,247, respectively, for its unsecured claim. In May 2006, the Board received an additional payment of \$158,278. The Board is expected to receive the final distribution in September 2006.

As of June 30, 2005, Delta Airlines Corp. presented a higher credit risk to the Board. The RFBP holds a \$3 million par 10.0% Delta Airlines Corp. bond maturing June 5, 2013, a \$1.971 million par 10.0% Delta Airlines Corp. bond maturing June 5, 2011 and a \$6 million par 10.14% Delta Airlines Corp. bond maturing August 14, 2012. Due to a weak credit outlook and potential bankruptcy, the Board stopped the interest income accruals after the December 2004 and February 2005 pay dates. Although the interest accruals were stopped, the Board received the interest due in June 2005 and August 2005. The combined book value of these securities was \$10,949,050 as of June 30, 2005. Due to the company's filing for Chapter 11 bankruptcy protection on September 14, 2005, the book values were reduced to \$1.5 million, \$985,500 and \$3 million, respectively. On March 20, 2006, the Board sold these securities and recorded a combined gain of \$892,680.

## 5. DEUTSCHE BANK SECURITIES, INC. COMPLAINT

The Board received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$5 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25, 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$538,632 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The Board tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of \$113.099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the Board received \$5,683,075 in principal and interest plus \$150,000 as a consent fee.

On December 11, 2003, the Supreme Court of the State of New York, New York County, entered an order dismissing Deutsche Bank's complaint on jurisdictional grounds. Deutsche Bank appealed that decision to the Appellate Division, which on June 14, 2005 reversed the Supreme Court and entered an order determining the Board to be liable and remanding the matter back to the Supreme Court for a determination of damages. The Board appealed that decision to the New York Court of Appeals, which on June 6, 2006 affirmed the Appellate Division's decision. The Board has since petitioned for certiorari to the United States Supreme Court on certain jurisdictional issues. At the same time, discovery is proceeding in the New York Supreme Court to determine damages.

## 6. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Implementation of electronic trading for the Short Term Investment Pool and the other fixed income portfolios, as managed by Board Staff, was completed in fiscal year 2006.

## 7. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities

transactions on the State Street accounting system using the INSIGHT download function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 8. YEAR END PORTFOLIO

The June 30, 2006 RFBP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

| <u>Security Name</u>                  | <u>Coupon Maturity</u> |                 | <u>Par</u>         | <u>Book Value</u>  | <u>Fair Value</u>  | <u>%</u>     |
|---------------------------------------|------------------------|-----------------|--------------------|--------------------|--------------------|--------------|
| STATE STREET REPURCHASE AGREEMENT     | 4.500                  | 07/03/06        | 447,861            | 447,861            | 447,861            | 0.02%        |
| SHORT TERM INVESTMENT POOL            |                        |                 | 109,116,501        | 109,116,501        | 109,116,501        | 5.94%        |
| <b>Cash Equivalents</b>               | <b>2</b>               | <b>Issue(s)</b> | <b>109,564,362</b> | <b>109,564,362</b> | <b>109,564,362</b> | <b>5.96%</b> |
| AA / FT WORTH HQ FINANCE TRUST        | 5.500                  | 10/05/10        | 6,587,293          | 6,587,293          | 6,412,993          | 0.35%        |
| AOL TIME WARNER INC                   | 6.750                  | 04/15/11        | 10,000,000         | 10,444,987         | 10,252,070         | 0.56%        |
| AERO 1 HQ FINANCE TRUST               | 4.640                  | 07/07/10        | 5,745,000          | 5,745,000          | 5,314,355          | 0.29%        |
| AMERICA WEST AIRLINES EQUIPMENT TRUST | 7.930                  | 01/02/19        | 4,380,546          | 4,380,546          | 4,621,476          | 0.25%        |
| AMERICAN EXPRESS CO                   | 4.750                  | 06/17/09        | 3,000,000          | 2,997,031          | 2,933,112          | 0.16%        |
| AMERICAN GEN FINANCE CORP             | 4.625                  | 05/15/09        | 6,000,000          | 6,016,501          | 5,825,130          | 0.32%        |
| ARIA CDO                              | VAR                    | 10/10/12        | 25,000,000         | 25,000,000         | 24,874,750         | 1.35%        |
| ATCHISON TOPEKA + SANTA FE RY         | 6.550                  | 01/06/13        | 5,130,921          | 5,130,921          | 5,197,602          | 0.28%        |
| B J SERVICES                          | 5.750                  | 06/01/11        | 7,000,000          | 6,990,946          | 6,935,089          | 0.38%        |
| BANK ONE TEXAS NA                     | 6.250                  | 02/15/08        | 4,000,000          | 3,946,856          | 4,040,237          | 0.22%        |
| BANKBOSTON NA                         | 6.375                  | 03/25/08        | 4,000,000          | 3,947,974          | 4,050,791          | 0.22%        |
| BAYERISCHE LANDESBANK                 | VAR                    | 09/27/11        | 25,000,000         | 25,000,000         | 19,000,000         | 1.03%        |
| BELLSOUTH CORP                        | 4.750                  | 11/15/12        | 2,000,000          | 1,996,110          | 1,854,422          | 0.10%        |
| BELLSOUTH TELECOMM INC                | 6.300                  | 12/15/15        | 12,529,000         | 13,539,185         | 12,507,600         | 0.68%        |
| BISHOPSGATE CDO                       | 5.180                  | 06/30/10        | 25,000,000         | 25,000,000         | 23,652,500         | 1.29%        |
| BORG WARNER AUTOMOTIVE INC            | 7.000                  | 11/01/06        | 5,000,000          | 5,000,916          | 5,025,391          | 0.27%        |
| BURLINGTON NORTHN RR CO               | 7.970                  | 01/01/15        | 3,214,857          | 3,214,857          | 3,476,772          | 0.19%        |
| BURLINGTON NORTHN RR CO               | 6.940                  | 01/02/14        | 2,962,735          | 2,962,735          | 3,122,528          | 0.17%        |
| CIT GROUP INC                         | 4.750                  | 12/15/10        | 7,000,000          | 7,200,833          | 6,715,604          | 0.37%        |
| CSX CORP                              | 7.450                  | 05/01/07        | 3,000,000          | 3,017,564          | 3,044,579          | 0.17%        |
| CSX CORP                              | 7.900                  | 05/01/17        | 4,588,000          | 4,586,558          | 5,262,643          | 0.29%        |
| CANADIAN NATIONAL RAILWAY CO          | 6.800                  | 07/15/18        | 6,000,000          | 5,971,520          | 6,472,484          | 0.35%        |
| CANADIAN PACIFIC LTD                  | 9.450                  | 08/01/21        | 5,000,000          | 5,124,171          | 6,625,465          | 0.36%        |
| CAPITAL ONE BANK                      | 5.000                  | 06/15/09        | 6,000,000          | 5,993,297          | 5,876,970          | 0.32%        |
| CENTEX CORP                           | 4.550                  | 11/01/10        | 9,000,000          | 8,989,845          | 8,434,305          | 0.46%        |
| CHAMPION INTERNATIONAL CORP           | 7.150                  | 12/15/27        | 7,000,000          | 6,880,410          | 6,803,226          | 0.37%        |
| CHICAGO + NORTH WESTERN RY            | 8.910                  | 01/01/15        | 7,448,965          | 7,448,965          | 8,315,094          | 0.45%        |
| CITIGROUP INC                         | 6.200                  | 03/15/09        | 5,000,000          | 4,905,744          | 5,070,894          | 0.28%        |
| CITICORP CAPITAL II                   | 8.015                  | 02/15/27        | 4,000,000          | 3,973,015          | 4,155,037          | 0.23%        |
| COMCAST CORP                          | 5.450                  | 11/15/10        | 6,000,000          | 6,005,812          | 5,903,844          | 0.32%        |
| COMMERCIAL MORTGAGE TRUST             | 5.540                  | 06/10/46        | 8,000,000          | 8,019,453          | 7,972,349          | 0.43%        |
| CONTINENTAL AIRLINES EQUIPMENT TRUST  | 6.545                  | 08/02/20        | 6,423,079          | 6,423,079          | 6,361,203          | 0.35%        |
| CORPORATE PROPERTY REIT               | 7.875                  | 03/15/16        | 12,000,000         | 12,043,147         | 13,386,289         | 0.73%        |
| CREDIT SUISSE FIRST BOSTON USA        | 6.500                  | 01/15/12        | 10,000,000         | 10,591,962         | 10,318,490         | 0.56%        |
| CYPRESSTREE SYNTHETIC CDO             | VAR                    | 12/30/10        | 25,000,000         | 25,000,000         | 23,945,000         | 1.30%        |
| DOT HEADQUARTERS II LEASE MORTGAGE    | 0.000                  | 12/07/21        | 30,000,000         | 28,434,442         | 30,142,500         | 1.64%        |
| DEER PARK REFINING L P                | 6.470                  | 12/15/08        | 3,138,000          | 3,122,824          | 3,159,031          | 0.17%        |
| DONNELLEY R R + SONS CO               | 4.950                  | 04/01/14        | 5,000,000          | 4,673,424          | 4,501,655          | 0.25%        |
| DONNELLEY R R + SONS CO               | 4.950                  | 05/15/10        | 5,000,000          | 4,989,694          | 4,802,495          | 0.26%        |
| DUN + BRADSTREET CORP                 | 5.500                  | 03/15/11        | 10,000,000         | 9,998,587          | 9,833,160          | 0.54%        |
| EASTERN ENERGY LTD                    | 7.250                  | 12/01/16        | 5,000,000          | 4,953,158          | 5,663,809          | 0.31%        |
| EL PASO NATURAL GAS CO                | 8.625                  | 01/15/22        | 5,000,000          | 5,180,819          | 5,487,500          | 0.30%        |
| ENTERGY ARKANSAS INC                  | 4.500                  | 06/01/10        | 7,000,000          | 6,975,723          | 6,670,326          | 0.36%        |
| FPL ENERGY NATIONAL WIND LLC          | 5.608                  | 03/10/24        | 2,851,140          | 2,851,140          | 2,729,681          | 0.15%        |
| FIRST CHICAGO CORP                    | 6.375                  | 01/30/09        | 4,000,000          | 3,900,360          | 4,073,700          | 0.22%        |
| FIRST UNION BANK N C                  | 5.800                  | 12/01/08        | 6,000,000          | 5,837,443          | 6,031,307          | 0.33%        |

| <u>Security Name</u>                    | <u>Coupon</u> | <u>Maturity</u> | <u>Par</u> | <u>Book Value</u> | <u>Fair Value</u> | <u>%</u> |
|-----------------------------------------|---------------|-----------------|------------|-------------------|-------------------|----------|
| FLORIDA GAS TRANSMISSION CO             | 9.190         | 11/01/24        | 9,500,000  | 9,453,606         | 10,500,540        | 0.57%    |
| FORD MOTOR CREDIT CO                    | 7.375         | 10/28/09        | 8,000,000  | 8,004,345         | 7,368,602         | 0.40%    |
| FORD MOTOR CREDIT CO                    | 5.700         | 01/15/10        | 7,000,000  | 6,951,823         | 6,124,399         | 0.33%    |
| FORTUNE BRANDS INC                      | 5.375         | 01/15/16        | 10,000,000 | 9,939,970         | 9,250,260         | 0.50%    |
| GTE CORP                                | 7.900         | 02/01/27        | 14,000,000 | 14,000,000        | 14,222,694        | 0.77%    |
| GALENA CDO I                            | VAR           | 01/11/13        | 12,000,000 | 12,000,000        | 11,991,600        | 0.65%    |
| GENERAL AMERICAN TRANSN CORP EQUIPMENT  | 8.420         | 01/01/15        | 7,089,672  | 7,089,672         | 7,667,311         | 0.42%    |
| GENERAL ELECTRIC CAPITAL CORP           | 8.125         | 05/15/12        | 5,000,000  | 5,168,221         | 5,604,121         | 0.31%    |
| GENERAL ELECTRIC CAPITAL CORP           | 5.000         | 01/08/16        | 3,000,000  | 2,981,367         | 2,815,956         | 0.15%    |
| GENERAL MOTORS ACCEPTANCE CORP          | 6.125         | 08/28/07        | 5,000,000  | 5,004,497         | 4,937,906         | 0.27%    |
| GENERAL MOTORS ACCEPTANCE CORP          | 5.625         | 05/15/09        | 6,000,000  | 6,082,604         | 5,685,107         | 0.31%    |
| GENWORTH GLOBAL FUNDING TRUSTS          | 5.125         | 03/15/11        | 5,000,000  | 4,986,723         | 4,880,595         | 0.27%    |
| GEORGIA POWER CO                        | 5.250         | 12/15/15        | 3,000,000  | 3,000,170         | 2,862,549         | 0.16%    |
| HSBC FINANCE CORP                       | 5.500         | 01/19/16        | 10,000,000 | 9,956,963         | 9,523,680         | 0.52%    |
| HOUSEHOLD FINANCE CORP                  | 6.500         | 11/15/08        | 5,000,000  | 4,925,905         | 5,090,156         | 0.28%    |
| IBP FINANCIAL CO CANADA                 | 7.450         | 06/01/07        | 3,000,000  | 2,999,810         | 3,032,631         | 0.17%    |
| ING SECURITY LIFE INSTITUTIONAL FUNDING | 4.250         | 01/15/10        | 7,000,000  | 6,989,154         | 6,710,382         | 0.37%    |
| INTERNATIONAL LEASE FINANCE CORP        | 4.550         | 10/15/09        | 2,000,000  | 2,005,180         | 1,927,048         | 0.10%    |
| INTERNATIONAL PAPER CO                  | 6.875         | 11/01/23        | 3,000,000  | 2,969,068         | 2,952,632         | 0.16%    |
| INTERNATIONAL PAPER CO                  | 4.000         | 04/01/10        | 4,000,000  | 4,000,944         | 3,742,464         | 0.20%    |
| J P MORGAN CAPITAL TRUST                | 7.540         | 01/15/27        | 6,000,000  | 5,717,349         | 6,259,769         | 0.34%    |
| J P MORGAN CHASE COMMERCIAL TRUST       | 4.555         | 06/12/41        | 12,000,000 | 11,999,887        | 11,665,100        | 0.63%    |
| J P MORGAN CHASE COMMERCIAL TRUST       | 3.053         | 01/15/38        | 2,291,397  | 2,294,380         | 2,177,415         | 0.12%    |
| KCT INTERMODAL TRANSPORTATION CORP      | 6.884         | 08/01/18        | 3,317,333  | 3,317,333         | 3,430,195         | 0.19%    |
| KELLWOOD CO                             | 7.625         | 10/15/17        | 12,000,000 | 11,850,046        | 10,813,104        | 0.59%    |
| KERR MCGEE CORP                         | 7.125         | 10/15/27        | 7,000,000  | 7,078,208         | 7,035,000         | 0.38%    |
| KERR MCGEE CORP                         | 6.950         | 07/01/24        | 4,000,000  | 3,971,990         | 4,020,776         | 0.22%    |
| KEY BANK NA                             | 4.412         | 03/18/08        | 5,000,000  | 5,000,000         | 4,906,025         | 0.27%    |
| KEYBANK NA                              | 5.450         | 03/03/16        | 10,000,000 | 9,997,679         | 9,560,310         | 0.52%    |
| KRAFT FOODS INC                         | 4.125         | 11/12/09        | 2,000,000  | 1,993,439         | 1,900,970         | 0.10%    |
| LEHMAN BROTHERS HOLDINGS INC            | 3.950         | 11/10/09        | 7,000,000  | 6,990,620         | 6,616,134         | 0.36%    |
| MGIC INVT CORP                          | 5.375         | 11/01/15        | 10,000,000 | 9,864,559         | 9,372,170         | 0.51%    |
| MACMILLAN BLOEDEL LTD                   | 7.700         | 02/15/26        | 10,000,000 | 9,849,093         | 10,228,664        | 0.56%    |
| MARSH + MCLENNAN COS INC                | 7.125         | 06/15/09        | 7,000,000  | 6,997,635         | 7,214,101         | 0.39%    |
| MEAD CORP                               | 7.350         | 03/01/17        | 11,000,000 | 10,993,449        | 11,945,165        | 0.65%    |
| MED MAP L L C MONTANA                   | 7.060         | 12/01/15        | 8,595,000  | 8,595,000         | 8,681,810         | 0.47%    |
| MED MAP L L C MONTANA                   | 7.000         | 06/01/21        | 5,730,000  | 5,730,000         | 5,766,099         | 0.31%    |
| METLIFE INC                             | 5.000         | 11/24/13        | 5,000,000  | 4,964,446         | 4,703,825         | 0.26%    |
| METROPOLITAN LIFE GOLBAL                | 4.250         | 07/30/09        | 3,000,000  | 2,999,078         | 2,892,975         | 0.16%    |
| MOBIL CORP                              | 5.940         | 01/15/19        | 8,012,149  | 8,012,149         | 8,104,925         | 0.44%    |
| MORGAN J P + CO INC                     | 0.000         | 04/15/27        | 30,000,000 | 6,235,834         | 6,015,936         | 0.33%    |
| NATIONWIDE FINANCIAL SERVICES INC       | 8.000         | 03/01/27        | 6,000,000  | 5,922,260         | 6,205,693         | 0.34%    |
| NORFOLK SOUTHERN CORP                   | 7.700         | 05/15/17        | 6,000,000  | 6,022,565         | 6,774,690         | 0.37%    |
| OCCIDENTAL PETROLEUM CORP               | 7.200         | 04/01/28        | 10,000,000 | 9,873,109         | 11,152,164        | 0.61%    |
| OCCIDENTAL PETROLEUM CORP               | 8.750         | 01/15/23        | 6,000,000  | 5,959,984         | 7,582,297         | 0.41%    |
| OLD REPUBLIC INTERNATIONAL CORP         | 7.000         | 06/15/07        | 4,000,000  | 3,999,793         | 4,051,836         | 0.22%    |
| PNC FUNDING CORP                        | 4.200         | 03/10/08        | 10,000,000 | 9,997,350         | 9,752,160         | 0.53%    |
| PPL MONTANA LLC                         | 8.903         | 07/02/20        | 19,575,518 | 19,647,141        | 21,856,240        | 1.19%    |
| PACIFIC BELL                            | 7.250         | 11/01/27        | 6,000,000  | 5,964,006         | 5,920,604         | 0.32%    |
| PANAMERICAN BEVERAGES INC               | 7.250         | 07/01/09        | 6,000,000  | 5,982,274         | 6,480,000         | 0.35%    |
| PHILLIPS PETROLEUM CO                   | 7.125         | 03/15/28        | 11,000,000 | 10,862,576        | 11,039,174        | 0.60%    |
| PRUDENTIAL FINANCIAL INC                | 5.500         | 03/15/16        | 10,000,000 | 9,800,948         | 9,612,660         | 0.52%    |
| PUGET SOUND POWER + LIGHT CO            | 5.197         | 10/01/15        | 6,000,000  | 5,908,879         | 5,605,440         | 0.31%    |
| SLM CORP                                | 5.375         | 01/15/13        | 10,000,000 | 9,988,866         | 9,662,510         | 0.53%    |
| ST PAUL TRAVELERS COS INC               | 5.500         | 12/01/15        | 2,000,000  | 1,916,093         | 1,889,062         | 0.10%    |
| SEARIVER MARITIME FINANCIAL HOLDINGS    | 0.000         | 09/01/12        | 30,000,000 | 22,699,069        | 21,069,912        | 1.15%    |
| SECURITY CAP GROUP INC                  | 7.700         | 06/15/28        | 3,000,000  | 3,482,967         | 3,524,067         | 0.19%    |
| SOUTHERN UNION CO                       | 7.600         | 02/01/24        | 7,000,000  | 7,032,113         | 7,143,830         | 0.39%    |
| SOUTHWEST GAS CORP                      | 7.500         | 08/01/06        | 6,000,000  | 6,002,427         | 6,009,743         | 0.33%    |
| SOUTHWEST GAS CORP                      | 8.375         | 02/15/11        | 6,000,000  | 5,990,153         | 6,536,144         | 0.36%    |

| <u>Security Name</u>                   | <u>Coupon Maturity</u> |          | <u>Par</u>         | <u>Book Value</u>  | <u>Fair Value</u>  | <u>%</u>      |
|----------------------------------------|------------------------|----------|--------------------|--------------------|--------------------|---------------|
| SOUTHWESTERN BELL TEL CO               | 7.000                  | 11/15/27 | 3,000,000          | 2,997,051          | 2,902,762          | 0.16%         |
| TTX CO                                 | 6.050                  | 06/15/16 | 7,500,000          | 7,485,342          | 7,394,175          | 0.40%         |
| TEXAS GAS TRANSMISSION CORP            | 7.250                  | 07/15/27 | 3,000,000          | 2,789,483          | 3,281,184          | 0.18%         |
| TRANSCONTINENTAL GAS PIPE LINE         | 7.250                  | 12/01/26 | 3,000,000          | 3,002,675          | 3,033,750          | 0.17%         |
| TRISTATE GENERATION/TRANSPORT ASSOC    | 6.040                  | 01/31/18 | 8,000,000          | 8,066,549          | 7,847,099          | 0.43%         |
| TYSON FOODS INC                        | 8.250                  | 10/01/11 | 3,000,000          | 3,272,561          | 3,181,748          | 0.17%         |
| US BANK NA MINNEAPOLIS                 | 6.500                  | 02/01/08 | 5,000,000          | 4,999,770          | 5,075,937          | 0.28%         |
| ULTRAMAR DIAMOND SHAMROCK CORP         | 7.200                  | 10/15/17 | 3,000,000          | 2,984,348          | 3,083,849          | 0.17%         |
| UNION PACIFIC RESOURCES GROUP INC      | 7.050                  | 05/15/18 | 12,000,000         | 11,942,091         | 12,349,962         | 0.67%         |
| UNION TANK CAR CO                      | 7.450                  | 06/01/09 | 5,000,000          | 5,000,000          | 5,229,164          | 0.28%         |
| VERIZON COMMUNICATIONS INC             | 5.550                  | 02/15/16 | 5,000,000          | 4,961,441          | 4,688,195          | 0.26%         |
| VIRGINIA ELECTRIC + POWER CO           | 5.400                  | 01/15/16 | 10,000,000         | 9,938,381          | 9,417,760          | 0.51%         |
| WACHOVIA BANK NA                       | 5.600                  | 03/15/16 | 10,000,000         | 9,986,626          | 9,695,970          | 0.53%         |
| WAL MART STORES INC PASS THRU TRUST    | 7.490                  | 06/21/07 | 899,872            | 898,523            | 908,490            | 0.05%         |
| WASHINGTON MUTUAL INC                  | 4.200                  | 01/15/10 | 9,000,000          | 8,990,379          | 8,560,692          | 0.47%         |
| WESTERN PROPERTIES TRUST               | 7.200                  | 09/15/08 | 3,000,000          | 2,960,816          | 3,083,624          | 0.17%         |
| WESTVACO CORP                          | 7.650                  | 03/15/27 | 9,000,000          | 8,968,068          | 9,492,964          | 0.52%         |
| WEYERHAEUSER CO                        | 8.500                  | 01/15/25 | 7,000,000          | 7,260,808          | 8,002,905          | 0.44%         |
| WEYERHAEUSER CO                        | 6.750                  | 03/15/12 | 7,000,000          | 7,353,473          | 7,151,627          | 0.39%         |
| WILLAMETTE INDUSTRIES INC              | 7.000                  | 02/01/18 | 4,000,000          | 3,981,269          | 3,997,063          | 0.22%         |
| XANTERRA SOUTH RIM LLC                 | 5.690                  | 12/15/11 | 10,000,000         | 10,000,000         | 9,680,800          | 0.53%         |
| ZIONS BANCORPORATION                   | 5.650                  | 05/15/14 | 4,000,000          | 3,943,367          | 3,874,696          | 0.21%         |
| <b>Corporate (Rated)</b>               | <b>128 Issue(s)</b>    |          | <b>964,510,477</b> | <b>932,792,638</b> | <b>930,859,199</b> | <b>50.67%</b> |
| WILMINGTON TRUST TUCSON ELECTRIC       | 10.211                 | 01/01/09 | 4,752,202          | 4,752,202          | 4,865,400          | 0.26%         |
| AMERICAN PRESIDENT COS LTD             | 8.000                  | 01/15/24 | 5,000,000          | 4,765,001          | 4,500,000          | 0.24%         |
| FIRST INTERSTATE BANC SYS MONTANA      | 7.500                  | 10/01/06 | 3,220,000          | 3,220,000          | 3,220,000          | 0.18%         |
| MERIDIAN TRAILER TRAIN EQUIPMENT TRUST | 9.850                  | 01/29/10 | 861,875            | 861,875            | 898,936            | 0.05%         |
| MERIDIAN TRAILER TRAIN EQUIPMENT TRUST | 9.850                  | 01/29/08 | 436,692            | 436,692            | 444,552            | 0.02%         |
| <b>Corporate (Unrated)</b>             | <b>5 Issue(s)</b>      |          | <b>14,270,770</b>  | <b>14,035,771</b>  | <b>13,928,888</b>  | <b>0.76%</b>  |
| UNITED MEXICAN STATES                  | 5.875                  | 01/15/14 | 5,000,000          | 4,966,538          | 4,850,000          | 0.26%         |
| <b>Foreign Government Bonds</b>        | <b>1 Issue(s)</b>      |          | <b>5,000,000</b>   | <b>4,966,538</b>   | <b>4,850,000</b>   | <b>0.26%</b>  |
| ASTRO OFFSHORE CORP USGG XI            | 6.000                  | 12/20/19 | 10,883,000         | 10,883,000         | 10,638,133         | 0.58%         |
| ENSCO OFFSHORE CO USGG XI              | 6.360                  | 12/01/15 | 6,333,526          | 6,333,526          | 6,507,002          | 0.35%         |
| GNMA II POOL 001254                    | 9.500                  | 09/20/19 | 23,829             | 23,745             | 26,218             | 0.00%         |
| GNMA POOL 046249                       | 10.000                 | 12/15/10 | 4,017              | 4,005              | 4,269              | 0.00%         |
| GNMA POOL 135544                       | 10.000                 | 01/15/16 | 63,818             | 63,589             | 70,184             | 0.00%         |
| GLOBAL INDUSTRIES LTD USGG XI          | 7.710                  | 02/15/25 | 7,600,000          | 7,600,000          | 7,473,840          | 0.41%         |
| TUNISIA AID USGG XI                    | 6.710                  | 02/01/24 | 3,794,257          | 3,629,361          | 3,794,257          | 0.21%         |
| USGG SHIPPING + CENAC TOWING USGG XI   | 7.000                  | 05/15/21 | 7,564,000          | 7,564,000          | 7,564,000          | 0.41%         |
| VESSEL MANAGEMENT SERV INC USGG XI     | 6.080                  | 05/20/24 | 10,800,000         | 10,800,000         | 11,051,640         | 0.60%         |
| VESSEL MANAGEMENT SERV INC USGG XI     | 6.750                  | 06/15/25 | 7,800,000          | 7,800,000          | 8,378,526          | 0.46%         |
| <b>U.S. Government Direct-Backed</b>   | <b>10 Issue(s)</b>     |          | <b>54,866,448</b>  | <b>54,701,226</b>  | <b>55,508,068</b>  | <b>3.02%</b>  |
| FEDERAL HOME LOAN POOL B13150          | 4.000                  | 03/01/19 | 22,000,086         | 22,000,086         | 20,316,593         | 1.11%         |
| FEDERAL HOME LOAN POOL C01523          | 5.000                  | 03/01/33 | 9,567,690          | 9,493,114          | 8,985,406          | 0.49%         |
| FEDERAL HOME LOAN POOL E00247          | 5.500                  | 10/01/08 | 497,736            | 497,135            | 494,037            | 0.03%         |
| FEDERAL HOME LOAN POOL E00659          | 6.000                  | 04/01/14 | 491,577            | 491,305            | 492,787            | 0.03%         |
| FEDERAL HOME LOAN POOL E01376          | 4.000                  | 04/01/18 | 20,508,447         | 20,376,762         | 19,004,762         | 1.03%         |
| FEDERAL HOME LOAN POOL E01418          | 4.000                  | 07/01/18 | 20,466,689         | 20,032,430         | 18,896,058         | 1.03%         |
| FEDERAL HOME LOAN POOL E01425          | 4.500                  | 08/01/18 | 20,618,550         | 20,571,411         | 19,505,009         | 1.06%         |
| FEDERAL HOME LOAN POOL E99081          | 4.500                  | 09/01/18 | 18,897,264         | 18,797,631         | 17,873,869         | 0.97%         |
| FEDERAL HOME LOAN POOL G10173          | 6.000                  | 01/01/09 | 421,633            | 421,280            | 422,473            | 0.02%         |
| FEDERAL HOME LOAN POOL G11670          | 4.000                  | 03/01/15 | 27,483,855         | 27,087,620         | 25,677,265         | 1.40%         |
| FEDERAL HOME LOAN POOL G11777          | 5.000                  | 10/01/20 | 27,514,971         | 27,280,844         | 26,491,013         | 1.44%         |
| FEDERAL HOME LOAN POOL G11812          | 5.000                  | 12/01/20 | 33,196,585         | 32,736,673         | 31,961,188         | 1.74%         |
| FEDERAL HOME LOAN POOL G30006          | 7.000                  | 07/01/13 | 296,105            | 297,467            | 301,651            | 0.02%         |
| FEDERAL HOME LOAN POOL G02070          | 5.500                  | 03/01/36 | 29,501,080         | 28,851,322         | 28,353,960         | 1.54%         |
| FEDERAL HOME LOAN MORTGAGE CORP        | 5.000                  | 06/18/18 | 15,000,000         | 15,000,000         | 14,115,870         | 0.77%         |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.000                  | 06/12/13 | 13,000,000         | 12,125,447         | 11,838,476         | 0.64%         |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.000                  | 07/18/18 | 15,000,000         | 15,000,000         | 14,178,518         | 0.77%         |

| <u>Security Name</u>                   | <u>Coupon</u>       | <u>Maturity</u> | <u>Par</u>           | <u>Book Value</u>    | <u>Fair Value</u>    | <u>%</u>       |
|----------------------------------------|---------------------|-----------------|----------------------|----------------------|----------------------|----------------|
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.500               | 04/02/14        | 11,000,000           | 10,965,880           | 10,209,914           | 0.56%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 5.000               | 01/30/14        | 13,000,000           | 12,996,744           | 12,518,870           | 0.68%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.825               | 09/23/15        | 15,000,000           | 14,060,957           | 14,063,355           | 0.77%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 0.000               | 06/21/32        | 100,000,000          | 16,745,271           | 16,620,000           | 0.90%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 8.250               | 06/01/26        | 8,000,000            | 8,262,687            | 9,940,632            | 0.54%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 0.000               | 06/05/28        | 150,000,000          | 33,691,406           | 32,912,550           | 1.79%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 0.000               | 09/14/29        | 100,000,000          | 20,543,787           | 20,224,500           | 1.10%          |
| FEDERAL AGRICULTURAL MORTGAGE CORP     | 6.710               | 07/28/14        | 17,000,000           | 18,808,097           | 18,311,907           | 1.00%          |
| FEDERAL FARM CREDIT BANKS              | 5.450               | 04/21/20        | 12,000,000           | 11,716,026           | 11,292,480           | 0.61%          |
| FEDERAL FARM CREDIT BANKS              | 5.200               | 12/27/12        | 5,000,000            | 5,000,000            | 4,892,450            | 0.27%          |
| FEDERAL HOME LOAN BANKS                | 4.250               | 07/17/13        | 13,000,000           | 12,245,851           | 12,006,904           | 0.65%          |
| FEDERAL HOME LOAN BANKS                | 6.395               | 06/03/14        | 4,000,000            | 3,796,771            | 4,209,926            | 0.23%          |
| FEDERAL HOME LOAN BANKS                | 7.000               | 08/26/19        | 8,000,000            | 7,978,200            | 8,963,160            | 0.49%          |
| FEDERAL HOME LOAN BANKS                | 7.450               | 02/03/20        | 15,000,000           | 15,083,385           | 17,655,195           | 0.96%          |
| FEDERAL HOME LOAN BANKS                | 3.750               | 02/07/28        | 5,000,000            | 4,998,527            | 4,940,320            | 0.27%          |
| FEDERAL HOME LOAN BANKS                | 4.125               | 08/13/10        | 25,000,000           | 25,213,965           | 23,773,575           | 1.29%          |
| FEDERAL HOME LOAN BANKS                | 5.000               | 08/28/19        | 15,000,000           | 15,000,000           | 14,680,500           | 0.80%          |
| FEDERAL HOME LOAN BANKS                | 5.410               | 05/26/10        | 15,000,000           | 15,000,000           | 14,758,725           | 0.80%          |
| FEDERAL HOME LOAN MORTGAGE PC REMIC    | 9.300               | 11/15/20        | 95,975               | 93,813               | 95,461               | 0.01%          |
| FEDERAL HOME LOAN MORTGAGE PC REMIC    | VAR                 | 08/15/07        | 298,816              | 1                    | 1,437                | 0.00%          |
| FEDERAL HOME LOAN MORTGAGE PC REMIC    | VAR                 | 09/15/07        | 199,115              | 1                    | 1,125                | 0.00%          |
| FEDERAL NATL MTG ASSN REMIC IO         | VAR                 | 08/25/07        | 292,059              | 1                    | 5,575                | 0.00%          |
| FEDERAL NATL MTG ASSN REMIC            | 9.500               | 03/25/20        | 296,464              | 293,239              | 317,047              | 0.02%          |
| FEDERAL NATIONAL MORTGAGE ASSN         | 6.000               | 05/15/08        | 30,000,000           | 29,755,515           | 30,282,939           | 1.65%          |
| FEDERAL NATIONAL MORTGAGE ASSN         | 7.250               | 01/15/10        | 17,000,000           | 16,997,909           | 17,959,145           | 0.98%          |
| FEDERAL NATIONAL MORTGAGE ASSN         | 6.625               | 11/15/10        | 5,000,000            | 5,095,104            | 5,219,072            | 0.28%          |
| FEDERAL NATIONAL MORTGAGE ASSN         | 4.500               | 08/15/08        | 10,000,000           | 10,000,000           | 9,808,810            | 0.53%          |
| FNMA POOL 256083                       | 6.000               | 01/01/26        | 23,661,358           | 23,573,185           | 23,505,927           | 1.28%          |
| FNMA POOL 303365                       | 6.500               | 05/01/09        | 689,979              | 685,946              | 699,736              | 0.04%          |
| FNMA POOL 303125                       | 7.500               | 01/01/10        | 247,304              | 246,922              | 250,271              | 0.01%          |
| FNMA POOL 303202                       | 6.500               | 05/01/14        | 595,873              | 592,064              | 602,191              | 0.03%          |
| FNMA POOL 303590                       | 7.000               | 11/01/10        | 322,708              | 322,708              | 327,191              | 0.02%          |
| FNMA POOL 313999                       | 6.000               | 02/01/13        | 652,778              | 650,629              | 655,404              | 0.04%          |
| FNMA POOL 572220                       | 6.000               | 03/01/16        | 716,958              | 715,437              | 720,403              | 0.04%          |
| FNMA POOL 592327                       | 5.500               | 06/01/16        | 1,329,323            | 1,306,166            | 1,307,670            | 0.07%          |
| FNMA POOL 725346                       | 4.000               | 03/01/19        | 22,692,416           | 22,482,014           | 20,976,177           | 1.14%          |
| FNMA POOL 745250                       | 5.000               | 01/01/21        | 28,684,645           | 28,562,268           | 27,634,772           | 1.50%          |
| FNMA POOL 780956                       | 4.500               | 05/01/19        | 22,732,325           | 22,726,116           | 21,514,178           | 1.17%          |
| FREDDIE MAC                            | 4.100               | 01/28/14        | 35,000,000           | 35,000,000           | 33,381,005           | 1.82%          |
| U S ARMY HOSPITALITY FUND              | 7.467               | 05/01/32        | 14,370,889           | 14,370,889           | 16,184,495           | 0.88%          |
| <b>U.S. Government Indirect-Backed</b> | <b>49 Issue(s)</b>  |                 | <b>1,020,341,254</b> | <b>736,638,007</b>   | <b>722,333,929</b>   | <b>39.32%</b>  |
| <b>Total RFBP</b>                      | <b>203 Issue(s)</b> |                 | <b>2,168,553,312</b> | <b>1,852,698,544</b> | <b>1,837,044,446</b> | <b>100.00%</b> |

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Trust Funds Bond Pool, as of June 30, 2006, and 2005, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Trust Funds Bond Pool, as of June 30, 2006, and 2005, and its changes in net asset value and investment income and distribution for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
TRUST FUNDS BOND POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2006 AND 2005

|                                                                                                                              | <u>2006</u>             | <u>2005</u>             |
|------------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| <u>Assets</u>                                                                                                                |                         |                         |
| Cash                                                                                                                         | \$ 0                    | \$ 0                    |
| Security lending cash collateral (Notes 3 and 4)                                                                             | 61,814,106              | 159,415,025             |
| Interest receivable                                                                                                          | 16,269,788              | 16,775,208              |
| Investments managed at fair value (amortized cost of \$1,323,175,351 in 2006 and \$1,270,289,093 in 2005) (Notes 2, 4 and 9) | <u>1,314,596,488</u>    | <u>1,331,695,138</u>    |
| Total assets                                                                                                                 | \$ <u>1,392,680,382</u> | \$ <u>1,507,885,371</u> |
| <u>Liabilities</u>                                                                                                           |                         |                         |
| Income due participants (Note 2)                                                                                             | \$ 8,358,662            | \$ 8,228,520            |
| Broker payable for securities purchased but not settled (Note 2)                                                             | 0                       | 9,000,000               |
| Security lending obligations (Notes 3 and 4)                                                                                 | 61,814,106              | 159,415,025             |
| Security lending expense payable                                                                                             | <u>254,820</u>          | <u>401,325</u>          |
| Total liabilities                                                                                                            | <u>70,427,588</u>       | <u>177,044,870</u>      |
| Net asset value                                                                                                              | \$ <u>1,322,252,794</u> | \$ <u>1,330,840,501</u> |
| Units Outstanding (Note 2)                                                                                                   | 13,757,064              | 13,130,701              |
| Unit Value (Note 2)                                                                                                          | \$ 96.11                | \$ 101.35               |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                              |                         |                         |
|----------------------------------------------|-------------------------|-------------------------|
| Net asset value, beginning of year           | \$ 1,330,840,501        | \$ 1,262,690,838        |
| Value of units purchased by participants     | 96,950,097              | 68,871,431              |
| Value of units sold by participants          | (34,220,847)            | (17,143,652)            |
| Changes in fair value of investments managed | <u>(71,316,957)</u>     | <u>16,421,884</u>       |
| Net asset value, end of year                 | \$ <u>1,322,252,794</u> | \$ <u>1,330,840,501</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                               |                     |                     |
|-----------------------------------------------|---------------------|---------------------|
| Interest income (Note 2)                      | \$ 68,387,650       | \$ 67,804,006       |
| Amortization/accretion                        | 6,670,909           | 5,102,743           |
| Net realized gains (Note 2)                   | 692,463             | 12,452,243          |
| Security lending income                       | 4,417,859           | 3,217,273           |
| Security lending expense                      | (4,338,195)         | (3,040,824)         |
| Administrative expenses                       | (316,821)           | (218,667)           |
| Income due participants, beginning of year    | <u>8,228,520</u>    | <u>8,651,899</u>    |
| Income available for distribution             | 83,742,385          | 93,968,673          |
| Distribution                                  | <u>75,383,723</u>   | <u>85,740,153</u>   |
| Income due participants, end of year (Note 2) | \$ <u>8,358,662</u> | \$ <u>8,228,520</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
TRUST FUNDS BOND POOL

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2006 AND 2005

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Trust Funds Bond Pool (TFBP) was created by the Board to allow qualifying funds, per section 17-6-201, MCA, to participate in a diversified pool. The TFBP was created on October 1, 1995, by the transfer of all fixed income and variable-rate securities owned by six state trust funds. Since the pool's creation in 1995, the funds listed below became participants in the TFBP:

|                                                    |                |
|----------------------------------------------------|----------------|
| University of Montana Endowment Fund*              | January 1996   |
| Montana Pole Superfund                             | September 1996 |
| Upper Clark Fork River Basin (UCFRB) Restoration   | July 1999      |
| Upper Clark Fork River Basin (UCFRB) Cost Recovery | July 1999      |
| Streamside Tailings Operable Unit                  | July 1999      |
| Treasure State Regional Water Systems              | July 2000      |
| Tobacco Trust Fund                                 | January 2001   |
| University of Montana Designated Fund*             | July 2002      |
| University of Montana Other Fund*                  | July 2002      |
| Montana Tech of the U of M                         | March 2003     |
| Real Property Trust                                | September 2003 |
| Wildlife Habitat                                   | September 2003 |
| Acquisition Trust                                  | April 2004     |
| Bair Trust Fund                                    | April 2004     |
| Bradley Trust                                      | April 2004     |
| Merritt Wheeler Trust                              | April 2004     |
| Sobotka Memorial Trust                             | April 2004     |
| Teakle Trust                                       | April 2004     |
| Montana State University                           | July 2004      |
| Big Sky Economic Development Fund                  | July 2005      |
| Stewart Trust                                      | January 2006   |

\* In July 2005, the University of Montana requested the University of Montana Endowment Fund and the University of Montana Designated Fund be closed and transferred, at cost, into the University of Montana Other Fund.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

The TFBP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The TFBP portfolio includes securities classified as corporate, foreign government bonds, municipals, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

The TFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as U.S. government indirect-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 9 for the Year End Portfolio)

TFBP fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The TFBP variable-rate securities float with LIBOR (London Interbank Offered Rate). As of June 30, 2006, three variable-rate securities, with a total amortized cost of \$39,000,000, are identified and reported as corporate securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Disclosures and Note 9 for the Year End Portfolio.) As of June 30, 2005, three variable-rate securities, with a total amortized cost of \$29,000,000, are identified and reported as corporate or U.S. government indirect-backed securities in the investment risk and portfolio disclosures.

Investments are presented in the Statement of Net Asset Value at fair value. Fair values for securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

The TFBP, as an internal investment pool, invests its excess cash in the Board's Short Term Investment Pool (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

#### Participant Units

The Coal Severance Tax Permanent Trust, Resource Indemnity Trust, Coal Tax Park Trust, Trust and Legacy, Coal Tax Cultural Trust, and Treasure State Endowment Trust funds transferred all fixed income and variable-rate securities, at amortized cost, into the TFBP at the start-up date and were issued units according to the fair value of each participant's portfolio. The initial unit value as of October 1, 1995, was \$100.00. Unit values are calculated weekly and at month end, based on portfolio pricing, to allow for participant transactions to occur as determined by the investment staff.

The June 30, 2006 unit value of \$96.11 decreased from a June 30, 2005 unit value of \$101.35. The yield on longer term bonds increased during the fiscal year, which has the effect of decreasing bond prices and the pool unit value. A one percent (1%) change in interest rates is expected to have a three to five percent (3%-5%) inverse change in the unit value. TFBP investments are considered long-term in nature and participants require long-term time horizons.

#### Broker Receivable/Payable

TFBP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the TFBP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

#### Other

Accumulated income, recorded as Income Due Participants, is distributed monthly on the first calendar day of each month. Realized portfolio gains/losses are distributed at least annually to the participants.

Interest income reported in the Statement of Investment Income and Distribution includes interest accruals and miscellaneous income.

Administrative expenses incurred by the Board are charged daily to TFBP based on the Board's expenses applicable to TFBP. These expenses include costs for the custodial bank contract.

### 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 102 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults. The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street Bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during

fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street Bank.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2006, the carrying and fair value of the underlying securities on loan for the TFBP was \$69,156,566 and \$68,572,311, respectively. The collateral provided for the securities on loan totaled \$71,083,106 representing \$61,814,106 in cash and \$9,269,000 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$5,054,589 corporate, \$312,892 foreign government bonds, and \$63,789,085 U.S. government indirect-backed.

As of June 30, 2005, the carrying and fair value of the underlying securities on loan for the TFBP was \$151,184,341 and \$157,922,586, respectively. The collateral provided for the securities on loan totaled \$162,631,521 representing \$159,415,025 in cash and \$3,216,496 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$20,985,615 corporate, \$2,628,923 foreign government bonds, \$52,176,907 U.S. government direct-backed, and \$75,392,895 U.S. government indirect-backed.

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

##### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the TFBP fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires TFBP fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the table below are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, all the fixed income securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The State Street repurchase agreement was purchased in the State of Montana Board of Investments name.

##### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement. According to the TFBP Investment Policy, "with the exception of U.S. government indirect-backed (agency) securities, additional TFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". The TFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 7.75% as of June 30, 2006 and 8.19% as of June 30, 2005.

##### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The TFBP investment policy does not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the

average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs and ARMs)."

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

As reported in the U.S. government indirect-backed category, the TFBP portfolio holds REMICs totaling \$84,804 and \$113,944, respectively, at amortized cost, as of June 30, 2006 and June 30, 2005. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

The TFBP holds one inverse variable rate corporate \$15 million par bond. The quarterly coupon is calculated at a set rate less the 12 month LIBOR in arrears. As interest rates increase, the coupon paid will decline.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2006 and June 30, 2005. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

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Credit Quality Rating and Effective Duration as of June 30, 2006

| <u>Security Investment Type</u>               |   | <u>Fair Value</u>    | <u>Credit Quality Rating</u> | <u>Effective Duration</u> |
|-----------------------------------------------|---|----------------------|------------------------------|---------------------------|
| Corporate Bonds (Rated)                       | S | 643,216,700          | A                            | 4.93                      |
| Corporate Bonds (Unrated)                     |   | 3,812,700            | NR                           | 1.48                      |
| Foreign Government Bonds                      |   | 9,700,000            | BBB                          | 5.83                      |
| Municipal Government Bonds (Rated)            |   | 1,167,858            | AA                           | 2.70                      |
| Municipal Government Bonds (Unrated)          |   | 2,656,472            | NR                           | 3.94                      |
| U.S. Government Direct-Backed                 |   | 58,629,125           | AAA                          | 7.37                      |
| U.S. Government Indirect-Backed               |   | 509,562,146          | AAA                          | 4.77                      |
| State Street Repurchase Agreement* (Rated)    |   | 268,717              | AA-                          | N/A                       |
| Short Term Investment Pool (STIP)             |   | <u>85,582,770</u>    | <u>NR</u>                    | N/A                       |
| Total Investments                             | S | <u>1,314,596,488</u> | <u>AA-</u>                   | <u>4.97</u>               |
| Securities Lending Collateral Investment Pool | S | <u>61,814,106</u>    | NR                           | NA                        |

\* At June 30, 2006, the State Street Bank repurchase agreement was collateralized at \$269,625 by a AAA rated Federal Home Loan Mortgage Corporation note maturing May 15, 2008.

Credit Quality Rating and Effective Duration as of June 30, 2005

| <u>Security Investment Type</u>               |   | <u>Fair Value</u>    | <u>Credit Quality Rating</u> | <u>Effective Duration</u> |
|-----------------------------------------------|---|----------------------|------------------------------|---------------------------|
| Corporate Bonds (Rated)                       | S | 665,536,568          | A-                           | 5.42                      |
| Corporate Bonds (Unrated)                     |   | 5,956,312            | NR                           | 2.12                      |
| Foreign Government Bonds                      |   | 10,435,000           | BBB                          | 6.67                      |
| Municipal Government Bonds (Rated)*           |   | 1,140,000            | AA                           | 3.50                      |
| Municipal Government Bonds (Unrated)*         |   | 4,983,270            | NR                           | 2.37                      |
| U.S. Government Direct-Backed                 |   | 120,326,386          | AAA                          | 6.14                      |
| U.S. Government Indirect-Backed               |   | 455,262,802          | AAA                          | 3.86                      |
| State Street Repurchase Agreement** (Rated)   |   | 3,307,867            | AA-                          | NA                        |
| Short Term Investment Pool (STIP)             |   | <u>64,746,933</u>    | <u>NR</u>                    | NA                        |
| Total Investments                             | S | <u>1,331,695,138</u> | <u>AA-</u>                   | <u>4.91</u>               |
| Securities Lending Collateral Investment Pool | S | <u>159,415,025</u>   | NR                           | NA                        |

\*The Municipal Government Bond investment type has been restated to report the separate rating and duration for the Rated and Unrated Municipal Government Bonds as of June 30, 2005. The Rated and Unrated Municipal Government Bonds were previously reported as \$6,123,270 Unrated with a Credit Quality Rating of NR and an Effective Duration of 2.58.

\*\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at \$3,389,890 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

Specific Legal and Credit Risk

As of June 30, 2006 and June 30, 2005, Northwest Airlines Inc. presented a higher credit risk to the Board. The TFBP held a \$9,255,000 par 4.64% Northwest Airlines Inc. real estate backed bond maturing July 7, 2010. This bond, with a June 30, 2006 and 2005 book value of \$9,255,000, is secured by Northwest Airlines Inc.'s corporate headquarters building and land.

As of June 30, 2005, the TFBP held a \$10,757,539 par 6.81% Northwest Airlines Inc. bond maturing February 1, 2020 and a \$3,901,307 par 7.935% Northwest Airlines Inc. MBIA Insurance Corp insured bond maturing April 1, 2019. The combined book value of these two securities was \$14,356,399 as of June 30, 2005. On September 14, 2005, the company filed for Chapter 11 bankruptcy protection. Due to this action, the Board stopped the interest income accruals for the 6.81% bond maturing February 1, 2020 after the August 2005 pay date. This issue was sold on September 20, 2005 generating a loss of \$809,221. The sale included accrued interest from August 1, 2005 to September 20, 2005. Since the 7.935% bond maturing April 1, 2019 is insured by MBIA Insurance Corp. to support the payment of any interest due and outstanding principal balance, the Board did not stop the interest income accrual or reduce book value. On January 11, 2006 Northwest Airlines Inc. called the 7.935% bond maturing April 1, 2019 at par and included accrued interest from October 1, 2005 to January 11, 2006. The Board recorded a gain of \$37,800 on this transaction.

As of June 30, 2006 and June 30, 2005, Burlington Industries, Inc. presented a legal and higher credit risk to the Board. The Board owns a Burlington Industries, Inc., \$4 million par, 7.25% bond maturing September 15, 2005. In September 2000, the company announced a reduction of stockholders equity. Due to an increasing senior bank line and declining credit trend, the bond ratings for this issue were downgraded, in May 2001, by the Moody's and Standard & Poor's rating agencies. During fiscal year 2001, the book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of \$3,739,760 to \$1,600,000. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to \$800,000. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the Board received \$969,974 in August 2004 for its unsecured claim. This transaction reduced the book value to \$0 and generated a gain of \$169,974. In February 2005 and May 2005, the Board received an additional \$139,180 and \$129,498, respectively, for its unsecured claim. In May 2006, the Board received an additional payment of \$105,519. The Board is expected to receive the final distribution in September 2006.

As of June 30, 2005, Delta Airlines Corp. presented a higher credit risk to the Board. The TFBP holds a \$2 million par 10.0% Delta Airlines Corp. bond maturing June 5, 2013 and a \$3 million par 10.14% Delta Airlines Corp. bond maturing August 14, 2012. Due to a weak credit outlook and potential bankruptcy, the Board stopped the interest income accruals after the December 2004 and February 2005 pay dates. Although the interest accruals were stopped, the Board received the interest due in June 2005 and August 2005. The combined book value of these securities was \$4,994,602 as of June 30, 2005. Due to the company's filing for Chapter 11 bankruptcy protection on September 14, 2005, the book values were reduced to \$1 million and \$1.5 million, respectively. On March 20, 2006, the Board sold these securities and recorded a combined gain of \$410,000.

## 5. PARTICIPANT LOAN

In accordance with Senate Bill 495 enacted by the 2001 Legislature, the Coal Severance Tax Permanent Trust loaned 483,604 TFBP shares, with a book value of \$46,366,904, to the Trust and Legacy fund on July 2, 2001. The loan proceeds were deposited in the Trust and Legacy Fund. A loan receivable was recorded in the Coal Severance Tax Permanent Trust and a corresponding liability was recorded in the Guarantee Fund, a General Fund sub-fund. The August 2002 Special Legislative Session approved the request to record this activity in a state special revenue fund of the Office of Public Instruction rather than in the Guarantee Fund. In fiscal year 2006, the Trust and Legacy Fund paid \$10,848,960 to the Coal Severance Tax Permanent Trust. These transactions reduced the TFBP shares on loan to 323,819 with a corresponding book value of \$31,047,064. During fiscal year 2005, the Trust and Legacy Fund paid \$2,650,063 to the Coal Severance Tax Permanent Trust reducing the TFBP shares on loan to 436,973 with a corresponding book value of \$41,896,024.

## 6. DEUTSCHE BANK SECURITIES, INC. COMPLAINT

The Board received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$8 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25, 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$861,811 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The Board tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of \$113.099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the Board received \$9,092,920 in principal and interest plus \$240,000 as a consent fee.

On December 11, 2003, the Supreme Court of the State of New York, New York County, entered an order dismissing Deutsche Bank's complaint on jurisdictional grounds. Deutsche Bank appealed that decision to the Appellate Division, which on June 14, 2005 reversed the Supreme Court and entered an order determining the Board to be liable and remanding the matter back to the Supreme Court for a determination of damages. The Board appealed that decision to the New York Court of Appeals, which on June 6, 2006 affirmed the Appellate Division's decision. The Board has since petitioned for certiorari to the United States Supreme Court on certain jurisdictional issues. At the same time, discovery is proceeding in the New York Supreme Court to determine damages.

## 7. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Implementation of electronic trading for the Short Term Investment Pool and the other fixed income portfolios, as managed by Board Staff, was completed in fiscal year 2006.

## 8. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT download function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 9. YEAR END PORTFOLIO

The June 30, 2006 TFBP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

| Security Name                       | Coupon            | Maturity | Par               | Book Value        | Fair Value        | %            |
|-------------------------------------|-------------------|----------|-------------------|-------------------|-------------------|--------------|
| STATE STREET REPURCHASE AGREEMENT   | 4.50              | 07/03/06 | 268,717           | 268,717           | 268,717           | 0.02%        |
| SHORT TERM INVESTMENT POOL          | NA                | NA       | 85,582,770        | 85,582,770        | 85,582,770        | 6.51%        |
| <b>Cash Equivalents</b>             | <b>2 Issue(s)</b> |          | <b>85,851,487</b> | <b>85,851,487</b> | <b>85,851,487</b> | <b>6.53%</b> |
| AA / FT WORTH HQ FINANCE TRUST      | 5.50              | 10/05/10 | 8,563,481         | 8,563,481         | 8,336,891         | 0.63%        |
| AOL TIME WARNER INC                 | 6.75              | 04/15/11 | 5,000,000         | 5,222,493         | 5,126,035         | 0.39%        |
| AERO I HQ FINANCE TRUST             | 4.64              | 07/07/10 | 9,255,000         | 9,255,000         | 8,561,245         | 0.65%        |
| AMERICA WEST AIRLINES EQUIPMENT TR  | 7.93              | 01/02/19 | 2,920,364         | 2,920,364         | 3,080,984         | 0.23%        |
| AMERICAN EXPRESS CO                 | 4.75              | 06/17/09 | 2,000,000         | 1,998,021         | 1,955,408         | 0.15%        |
| AMERICAN GEN FINANCE CORP           | 4.63              | 05/15/09 | 4,000,000         | 4,011,001         | 3,883,420         | 0.30%        |
| B J SERVICES                        | 5.75              | 06/01/11 | 5,000,000         | 4,993,533         | 4,953,635         | 0.38%        |
| BANK ONE TEXAS NA                   | 6.25              | 02/15/08 | 4,000,000         | 3,946,856         | 4,040,237         | 0.31%        |
| BANKBOSTON NA                       | 6.38              | 03/25/08 | 4,000,000         | 3,947,974         | 4,050,791         | 0.31%        |
| BAYERISCHE LANDESBANK               | VAR               | 09/27/11 | 15,000,000        | 15,000,000        | 11,400,000        | 0.87%        |
| BELLSOUTH CORP                      | 4.75              | 11/15/12 | 3,000,000         | 2,994,166         | 2,781,633         | 0.21%        |
| BELLSOUTH TELECOM INC               | 6.30              | 12/15/15 | 9,396,750         | 10,154,389        | 9,380,700         | 0.71%        |
| BISHOPSGATE CDO LTD                 | 5.18              | 06/30/10 | 10,000,000        | 10,000,000        | 9,461,000         | 0.72%        |
| BORG WARNER AUTOMOTIVE INC          | 7.00              | 11/01/06 | 1,000,000         | 1,001,234         | 1,005,078         | 0.08%        |
| BURLINGTON NORTHERN CO EQUIPMENT TR | 7.97              | 01/01/15 | 3,214,857         | 3,214,857         | 3,476,772         | 0.26%        |
| BURLINGTON NORTH SANTA FE EQUIP TR  | 7.16              | 01/02/20 | 12,443,950        | 12,443,950        | 13,177,232        | 1.00%        |
| CIT GROUP EQUIPMENT TRUST           | 6.49              | 01/05/21 | 10,291,623        | 10,291,623        | 10,653,894        | 0.81%        |
| CIT GROUP INC                       | 4.75              | 12/15/10 | 3,000,000         | 3,086,071         | 2,878,116         | 0.22%        |
| CNA FINANCIAL CORP                  | 6.45              | 01/15/08 | 5,000,000         | 5,020,874         | 5,019,755         | 0.38%        |
| CSX CORP                            | 7.45              | 05/01/07 | 2,000,000         | 1,999,748         | 2,029,719         | 0.15%        |
| CSX CORP                            | 7.90              | 05/01/17 | 4,588,000         | 4,586,558         | 5,262,643         | 0.40%        |
| CANADIAN NATIONAL RAILWAY CO        | 6.80              | 07/15/18 | 4,000,000         | 3,983,529         | 4,314,989         | 0.33%        |
| CAPITAL ONE BANK                    | 5.00              | 06/15/09 | 4,000,000         | 3,995,531         | 3,917,980         | 0.30%        |
| CENTEX CORP                         | 4.55              | 11/01/10 | 6,000,000         | 5,993,230         | 5,622,870         | 0.43%        |
| CHAMPION INTERNATIONAL CORP         | 7.15              | 12/15/27 | 3,000,000         | 2,945,069         | 2,915,668         | 0.22%        |
| CHICAGO + NORTH WESTERN RY          | 8.91              | 01/01/15 | 3,724,483         | 3,724,483         | 4,157,547         | 0.32%        |
| CITIGROUP INC                       | 6.20              | 03/15/09 | 5,000,000         | 4,905,744         | 5,070,894         | 0.39%        |

| Security Name                           | Coupon | Maturity | Par        | Book Value | Fair Value | %     |
|-----------------------------------------|--------|----------|------------|------------|------------|-------|
| CITICORP CAPITAL II                     | 8.02   | 02/15/27 | 6,000,000  | 5,959,523  | 6,232,555  | 0.47% |
| CLEVELAND ELECTRIC ILLUM CO             | 7.13   | 07/01/07 | 5,000,000  | 4,997,334  | 5,064,555  | 0.39% |
| COMCAST CORP                            | 5.45   | 11/15/10 | 4,000,000  | 4,003,875  | 3,935,896  | 0.30% |
| COMMERCIAL MORTGAGE TRUST               | 5.54   | 06/10/46 | 5,000,000  | 5,012,158  | 4,982,718  | 0.38% |
| CONTINENTAL AIRLINES EQUIPMENT TRUST    | 6.55   | 08/02/20 | 5,620,194  | 5,620,194  | 5,566,053  | 0.42% |
| CORPORATE PROPERTY REIT                 | 7.88   | 03/15/16 | 3,000,000  | 2,994,927  | 3,346,572  | 0.25% |
| CREDIT SUISSE FIRST BOSTON USA          | 6.50   | 01/15/12 | 5,000,000  | 5,295,981  | 5,159,245  | 0.39% |
| CYPRESSTREE SYNTHETIC CDO LTD           | VAR    | 12/30/10 | 15,000,000 | 15,000,000 | 14,367,000 | 1.09% |
| DOT HEADQUARTERS II LEASE MORTGAGE      | 0.00   | 12/07/21 | 20,000,000 | 18,956,295 | 20,095,000 | 1.53% |
| DEER PARK REFINING L P                  | 6.47   | 12/15/08 | 1,569,000  | 1,558,882  | 1,579,516  | 0.12% |
| DONNELLEY R R + SONS CO                 | 4.95   | 04/01/14 | 5,000,000  | 4,673,424  | 4,501,655  | 0.34% |
| DUN + BRADSTREET CORP                   | 5.50   | 03/15/11 | 5,000,000  | 5,002,445  | 4,916,580  | 0.37% |
| EASTERN ENERGY LTD                      | 7.25   | 12/01/16 | 10,000,000 | 9,906,316  | 11,327,617 | 0.86% |
| ENTERGY ARKANSAS INC                    | 4.50   | 06/01/10 | 5,000,000  | 4,982,659  | 4,764,519  | 0.36% |
| FIRST CHICAGO CORP                      | 6.38   | 01/30/09 | 4,000,000  | 3,900,360  | 4,073,700  | 0.31% |
| FIRST UNION BANK N C                    | 5.80   | 12/01/08 | 4,000,000  | 3,891,629  | 4,020,872  | 0.31% |
| FLORIDA GAS TRANSMISSION CO             | 9.19   | 11/01/24 | 4,750,000  | 4,750,000  | 5,250,270  | 0.40% |
| FLORIDA GAS TRANSMISSION CO             | 7.00   | 07/17/12 | 3,000,000  | 2,997,371  | 3,118,541  | 0.24% |
| FORD MOTOR CREDIT CO                    | 7.38   | 10/28/09 | 7,000,000  | 7,003,802  | 6,447,526  | 0.49% |
| FORD MOTOR CREDIT CO                    | 5.70   | 01/15/10 | 3,000,000  | 2,979,353  | 2,624,743  | 0.20% |
| FORTUNE BRANDS INC                      | 5.38   | 01/15/16 | 5,000,000  | 4,969,985  | 4,625,130  | 0.35% |
| GTE CORP                                | 7.90   | 02/01/27 | 6,000,000  | 6,000,000  | 6,095,440  | 0.46% |
| GALENA CDO I                            | VAR    | 01/11/13 | 9,000,000  | 9,000,000  | 8,993,700  | 0.68% |
| GENERAL AMERICAN TRANS CORP EQUIP TR    | 8.42   | 01/01/15 | 7,089,672  | 7,089,672  | 7,667,311  | 0.58% |
| GENERAL ELECTRIC CAPITAL CORP           | 5.00   | 01/08/16 | 2,000,000  | 1,987,578  | 1,877,304  | 0.14% |
| GENERAL MOTORS ACCEPTANCE CORP          | 6.13   | 08/28/07 | 5,000,000  | 5,004,497  | 4,937,906  | 0.38% |
| GENERAL MOTORS ACCEPTANCE CORP          | 5.63   | 05/15/09 | 4,000,000  | 4,055,069  | 3,790,072  | 0.29% |
| GENWORTH GLOBAL FUNDING TRUSTS          | 5.13   | 03/15/11 | 5,000,000  | 4,986,723  | 4,880,595  | 0.37% |
| GEORGIA POWER CO                        | 5.25   | 12/15/15 | 2,000,000  | 2,000,113  | 1,908,366  | 0.15% |
| HSBC FINANCE CORP                       | 5.50   | 01/19/16 | 5,000,000  | 4,978,481  | 4,761,840  | 0.36% |
| HOUSEHOLD FINANCE CORP                  | 6.50   | 11/15/08 | 5,000,000  | 4,926,693  | 5,090,156  | 0.39% |
| IBP FINANCIAL CO CANADA                 | 7.45   | 06/01/07 | 3,000,000  | 2,999,810  | 3,032,631  | 0.23% |
| ING SECURITY LIFE INSTITUTIONAL FUNDING | 4.25   | 01/15/10 | 5,000,000  | 4,992,253  | 4,793,130  | 0.36% |
| INTERNATIONAL LEASE FINANCE CORP        | 4.55   | 10/15/09 | 3,000,000  | 3,007,770  | 2,890,572  | 0.22% |
| INTERNATIONAL PAPER CO                  | 6.88   | 11/01/23 | 2,000,000  | 1,979,379  | 1,968,421  | 0.15% |
| INTERNATIONAL PAPER CO                  | 4.00   | 04/01/10 | 6,000,000  | 5,999,863  | 5,613,696  | 0.43% |
| J P MORGAN CAPITAL TRUST                | 7.54   | 01/15/27 | 4,000,000  | 3,811,566  | 4,173,179  | 0.32% |
| J P MORGAN CHASE COMMERCIAL TRUST       | 4.56   | 06/12/41 | 8,000,000  | 7,999,924  | 7,776,734  | 0.59% |
| J P MORGAN CHASE COMMERCIAL TRUST       | 3.05   | 01/15/38 | 6,874,191  | 6,883,139  | 6,532,244  | 0.50% |
| KCT INTERMODAL TRANSPORTATION CORP      | 6.88   | 08/01/18 | 1,658,667  | 1,658,667  | 1,715,098  | 0.13% |
| KELLWOOD CO                             | 7.63   | 10/15/17 | 8,000,000  | 7,931,736  | 7,208,736  | 0.55% |
| KERR MCGEE CORP                         | 7.13   | 10/15/27 | 3,000,000  | 3,033,518  | 3,015,000  | 0.23% |
| KERR MCGEE CORP                         | 6.95   | 07/01/24 | 3,000,000  | 2,978,992  | 3,015,582  | 0.23% |
| KEYBANK NATIONAL ASSOCIATION            | 5.45   | 03/03/16 | 5,000,000  | 4,998,839  | 4,780,155  | 0.36% |
| LEHMAN BROTHERS HOLDINGS INC            | 3.95   | 11/10/09 | 5,000,000  | 4,993,300  | 4,725,810  | 0.36% |
| MGIC INVESTMENT CORP                    | 5.38   | 11/01/15 | 5,000,000  | 4,932,280  | 4,686,085  | 0.36% |
| MACMILLAN BLOEDEL LTD                   | 7.70   | 02/15/26 | 5,000,000  | 4,902,919  | 5,114,332  | 0.39% |
| MARSH + MCLENNAN COS INC                | 7.13   | 06/15/09 | 5,000,000  | 5,036,045  | 5,152,929  | 0.39% |
| MEAD CORP                               | 7.35   | 03/01/17 | 4,000,000  | 3,997,618  | 4,343,696  | 0.33% |
| MED MAP L L C MONTANA                   | 7.06   | 12/01/15 | 4,005,000  | 4,005,000  | 4,045,451  | 0.31% |
| MED MAP L L C MONTANA                   | 7.00   | 06/01/21 | 4,405,000  | 4,405,000  | 4,432,752  | 0.34% |
| METLIFE INC                             | 5.00   | 11/24/13 | 5,000,000  | 4,964,446  | 4,703,825  | 0.36% |
| METROPOLITAN LIFE GOLBAL                | 4.25   | 07/30/09 | 2,000,000  | 1,999,385  | 1,928,650  | 0.15% |
| MOBIL CORP                              | 5.94   | 01/15/19 | 8,012,149  | 8,012,149  | 8,104,925  | 0.62% |
| MORGAN J P + CO INC                     | 0.00   | 04/15/27 | 70,000,000 | 14,550,280 | 14,037,184 | 1.07% |
| NATIONWIDE FINANCIAL SERVICES INC       | 8.00   | 03/01/27 | 4,000,000  | 3,948,174  | 4,137,129  | 0.31% |
| NORFOLK SOUTHERN CORP                   | 7.70   | 05/15/17 | 4,000,000  | 4,010,684  | 4,516,460  | 0.34% |
| OCCIDENTAL PETROLEUM CORP               | 7.20   | 04/01/28 | 5,000,000  | 4,891,389  | 5,576,082  | 0.42% |
| OCCIDENTAL PETROLEUM CORP               | 8.75   | 01/15/23 | 4,000,000  | 4,000,000  | 5,054,864  | 0.38% |
| OLD REPUBLIC INTERNATIONAL CORP         | 7.00   | 06/15/07 | 3,000,000  | 2,999,845  | 3,038,877  | 0.23% |
| PNC FUNDING CORP                        | 4.20   | 03/10/08 | 5,000,000  | 4,998,675  | 4,876,080  | 0.37% |

| Security Name                              | Coupon              | Maturity    | Par                | Book Value         | Fair Value         | %             |
|--------------------------------------------|---------------------|-------------|--------------------|--------------------|--------------------|---------------|
| PPL MONTANA LLC                            | 8.90                | 07/02/20    | 19,575,518         | 19,647,141         | 21,856,240         | 1.66%         |
| PACIFIC BELL                               | 7.25                | 11/01/27    | 4,000,000          | 3,976,004          | 3,947,069          | 0.30%         |
| PANAMERICAN BEVERAGES INC                  | 7.25                | 07/01/09    | 7,000,000          | 6,991,620          | 7,560,000          | 0.58%         |
| PHILLIPS PETROLEUM CO                      | 7.13                | 03/15/28    | 4,000,000          | 3,950,027          | 4,014,245          | 0.31%         |
| PRUDENTIAL FINANCIAL INC                   | 5.50                | 03/15/16    | 5,000,000          | 4,900,474          | 4,806,330          | 0.37%         |
| PUGET SOUND POWER + LIGHT CO               | 5.20                | 10/01/15    | 4,000,000          | 3,939,253          | 3,736,960          | 0.28%         |
| SLM CORP                                   | 5.38                | 01/15/13    | 5,000,000          | 4,994,433          | 4,831,255          | 0.37%         |
| ST PAUL TRAVELERS COS INC                  | 5.50                | 12/01/15    | 2,000,000          | 1,916,093          | 1,889,062          | 0.14%         |
| SEARIVER MARITIME FINANCIAL HOLDINGS       | 0.00                | 09/01/12    | 20,000,000         | 15,131,576         | 14,046,608         | 1.07%         |
| SECURITY CAP GROUP INC                     | 7.70                | 06/15/28    | 2,000,000          | 2,321,978          | 2,349,378          | 0.18%         |
| SOUTHERN UNION CO                          | 7.60                | 02/01/24    | 8,000,000          | 7,484,935          | 8,164,378          | 0.62%         |
| SOUTHWEST GAS CORP                         | 7.50                | 08/01/06    | 4,000,000          | 4,006,597          | 4,006,496          | 0.30%         |
| SOUTHWEST GAS CORP                         | 8.38                | 02/15/11    | 8,000,000          | 8,005,563          | 8,714,859          | 0.66%         |
| SOUTHWESTERN BELL TEL CO                   | 7.00                | 11/15/27    | 2,000,000          | 1,998,034          | 1,935,174          | 0.15%         |
| TTX CO                                     | 6.05                | 06/15/16    | 5,000,000          | 4,990,228          | 4,929,450          | 0.37%         |
| TEXAS GAS TRANSMISSION CORP                | 7.25                | 07/15/27    | 2,000,000          | 1,859,655          | 2,187,456          | 0.17%         |
| TRANSCONTINENTAL GAS PIPE LINE             | 7.25                | 12/01/26    | 2,000,000          | 2,009,979          | 2,022,500          | 0.15%         |
| TRISTATE GENERATION TRANSPORT ASSOC        | 6.04                | 01/31/18    | 7,000,000          | 7,044,366          | 6,866,212          | 0.52%         |
| TYSON FOODS INC                            | 8.25                | 10/01/11    | 2,000,000          | 2,056,270          | 2,121,165          | 0.16%         |
| USX MARATHON GROUP                         | 9.38                | 02/15/12    | 5,000,000          | 5,790,975          | 5,781,825          | 0.44%         |
| ULTRAMAR DIAMOND SHAMROCK CORP             | 7.20                | 10/15/17    | 2,000,000          | 1,989,566          | 2,055,899          | 0.16%         |
| UNION PACIFIC RESOURCES GROUP INC          | 7.05                | 05/15/18    | 6,000,000          | 5,949,335          | 6,174,981          | 0.47%         |
| UNION TANK CAR CO                          | 7.45                | 06/01/09    | 5,000,000          | 5,000,000          | 5,229,164          | 0.40%         |
| VIRGINIA ELECTRIC + POWER CO               | 5.40                | 01/15/16    | 5,000,000          | 4,969,190          | 4,708,880          | 0.36%         |
| WACHOVIA BANK NA                           | 5.60                | 03/15/16    | 5,000,000          | 4,993,313          | 4,847,985          | 0.37%         |
| WASHINGTON MUTUAL INC                      | 4.20                | 01/15/10    | 6,000,000          | 5,993,586          | 5,707,128          | 0.43%         |
| WESTERN PROPERTIES TRUST                   | 7.20                | 09/15/08    | 1,000,000          | 986,939            | 1,027,875          | 0.08%         |
| WESTVACO CORP                              | 7.65                | 03/15/27    | 6,000,000          | 5,978,712          | 6,328,643          | 0.48%         |
| WEYERHAEUSER CO                            | 8.50                | 01/15/25    | 8,000,000          | 9,123,222          | 9,146,177          | 0.70%         |
| WEYERHAEUSER CO                            | 6.75                | 03/15/12    | 3,000,000          | 3,151,489          | 3,064,983          | 0.23%         |
| WILLAMETTE INDUSTRIES INC                  | 7.00                | 02/01/18    | 1,000,000          | 947,315            | 999,266            | 0.08%         |
| XANTERRA SOUTH RIM LLC                     | 5.69                | 12/15/11    | 8,000,000          | 8,000,000          | 7,744,640          | 0.59%         |
| ZIONS BANCORPORATION                       | 5.65                | 05/15/14    | 3,000,000          | 2,957,525          | 2,906,022          | 0.22%         |
| <b>Corporate</b>                           | <b>120 Issue(s)</b> |             | <b>702,957,899</b> | <b>642,663,155</b> | <b>643,216,700</b> | <b>48.93%</b> |
| FIRST INTERSTATE BANC SYSTEM MONTANA       | 7.50                | 10/01/06    | 1,380,000          | 1,380,000          | 1,380,000          | 0.10%         |
| WILMINGTON TRUST TUCSON ELECTRIC           | 10.21               | 01/01/09    | 2,376,101          | 2,376,101          | 2,432,700          | 0.19%         |
| <b>Corporate (Unrated)</b>                 | <b>2 Issue(s)</b>   |             | <b>3,756,101</b>   | <b>3,756,101</b>   | <b>3,812,700</b>   | <b>0.29%</b>  |
| UNITED MEXICAN STATES                      | 5.88                | 01/15/14    | 10,000,000         | 9,933,077          | 9,700,000          | 0.74%         |
| <b>Foreign Government Bonds</b>            | <b>1 Issue(s)</b>   |             | <b>10,000,000</b>  | <b>9,933,077</b>   | <b>9,700,000</b>   | <b>0.74%</b>  |
| MONTANA STATE BOARD HOUSING                | 8.45                | 08/01/39    | 1,135,000          | 1,135,000          | 1,167,858          | 0.09%         |
| <b>Municipal Government Bonds(Rated)</b>   | <b>1 Issue(s)</b>   |             | <b>1,135,000</b>   | <b>1,135,000</b>   | <b>1,167,858</b>   | <b>0.09%</b>  |
| CRP (55 issues)                            | 6.00-7.50           | 11/15/06-15 | 2,656,472          | 2,656,472          | 2,656,472          | 0.20%         |
| <b>Municipal Government Bonds(Unrated)</b> | <b>55 Issue(s)</b>  |             | <b>2,656,472</b>   | <b>2,656,472</b>   | <b>2,656,472</b>   | <b>0.20%</b>  |
| BENDER SHIPBUILDING + REPAIR USGG XI       | 6.20                | 09/30/12    | 9,957,643          | 9,957,643          | 9,855,179          | 0.75%         |
| GLOBAL INDUSTRIES LTD USGG XI              | 7.71                | 02/15/25    | 7,600,000          | 7,600,000          | 7,473,840          | 0.57%         |
| GNMA POOL 032974                           | 9.50                | 09/15/09    | 18,013             | 17,556             | 18,705             | 0.00%         |
| GNMA POOL 038164                           | 10.00               | 01/15/10    | 49,409             | 49,326             | 51,916             | 0.00%         |
| GNMA POOL 039321                           | 10.00               | 12/15/09    | 13,202             | 13,180             | 13,858             | 0.00%         |
| GNMA POOL 281467                           | 9.00                | 09/15/19    | 8,157              | 8,131              | 8,763              | 0.00%         |
| REINAUER MARITIME CO LLC USGG XI           | 6.50                | 06/30/28    | 18,128,000         | 18,128,000         | 18,207,219         | 1.39%         |
| T T BARGE SERVICES USGG XI                 | 6.45                | 12/16/12    | 1,324,700          | 1,324,700          | 1,326,290          | 0.10%         |
| TUNISIA AID USGG XI                        | 6.71                | 02/01/24    | 3,794,257          | 3,629,361          | 3,794,257          | 0.29%         |
| VESSEL MANAGEMENT INC USGG XI              | 6.08                | 05/20/24    | 17,472,000         | 17,472,000         | 17,879,098         | 1.36%         |
| <b>U.S. Government Direct-Backed</b>       | <b>10 Issue(s)</b>  |             | <b>58,365,381</b>  | <b>58,199,898</b>  | <b>58,629,125</b>  | <b>4.46%</b>  |
| FEDERAL HOME LOAN POOL B13150              | 4.00                | 03/01/19    | 14,666,724         | 14,666,724         | 13,544,395         | 1.03%         |
| FEDERAL HOME LOAN POOL C01523              | 5.00                | 03/01/33    | 6,378,460          | 6,328,743          | 5,990,270          | 0.46%         |
| FEDERAL HOME LOAN POOL E00247              | 5.50                | 10/01/08    | 208,728            | 208,476            | 207,177            | 0.02%         |
| FEDERAL HOME LOAN POOL E00659              | 6.00                | 04/01/14    | 688,208            | 687,828            | 689,902            | 0.05%         |
| FEDERAL HOME LOAN POOL E01376              | 4.00                | 04/01/18    | 13,672,298         | 13,584,508         | 12,669,841         | 0.96%         |
| FEDERAL HOME LOAN POOL F01418              | 4.00                | 07/01/18    | 13,644,459         | 13,228,502         | 12,597,372         | 0.96%         |
| FEDERAL HOME LOAN POOL E01425              | 4.50                | 08/01/18    | 13,745,700         | 13,714,274         | 13,003,339         | 0.99%         |

| Security Name                          | Coupon              | Maturity | Par                  | Book Value           | Fair Value           | %              |
|----------------------------------------|---------------------|----------|----------------------|----------------------|----------------------|----------------|
| FEDERAL HOME LOAN POOL E99081          | 4.50                | 09/01/18 | 14,847,850           | 14,769,567           | 14,043,755           | 1.07%          |
| FEDERAL HOME LOAN POOL G02070          | 5.50                | 03/01/36 | 19,667,387           | 19,234,215           | 18,902,640           | 1.44%          |
| FEDERAL HOME LOAN POOL G10814          | 5.50                | 05/01/13 | 483,339              | 483,091              | 475,277              | 0.04%          |
| FEDERAL HOME LOAN POOL G10173          | 6.00                | 01/01/09 | 180,700              | 180,548              | 181,060              | 0.01%          |
| FEDERAL HOME LOAN POOL G11670          | 4.00                | 03/01/15 | 11,778,795           | 11,608,980           | 11,004,542           | 0.84%          |
| FEDERAL HOME LOAN POOL G11777          | 5.00                | 10/01/20 | 18,343,314           | 18,187,230           | 17,660,676           | 1.34%          |
| FEDERAL HOME LOAN POOL G11812          | 5.00                | 12/01/20 | 14,227,108           | 14,030,003           | 13,697,652           | 1.04%          |
| FEDERAL HOME LOAN POOL G30006          | 7.00                | 07/01/13 | 232,654              | 232,654              | 237,011              | 0.02%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 5.00                | 06/18/18 | 20,000,000           | 20,000,000           | 18,821,160           | 1.43%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.00                | 06/12/13 | 12,000,000           | 11,192,720           | 10,927,824           | 0.83%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.00                | 07/18/18 | 15,000,000           | 15,000,000           | 14,178,518           | 1.08%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.50                | 04/02/14 | 9,000,000            | 8,972,083            | 8,353,566            | 0.64%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 5.00                | 01/30/14 | 12,000,000           | 11,996,995           | 11,555,880           | 0.88%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 4.83                | 09/23/15 | 10,000,000           | 9,373,971            | 9,375,570            | 0.71%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 8.25                | 06/01/26 | 7,000,000            | 7,229,852            | 8,698,053            | 0.66%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 0.00                | 06/05/28 | 50,000,000           | 11,230,469           | 10,970,850           | 0.83%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 0.00                | 09/14/29 | 100,000,000          | 20,543,787           | 20,224,500           | 1.54%          |
| FEDERAL HOME LOAN MORTGAGE CORP        | 0.00                | 06/21/32 | 100,000,000          | 16,745,271           | 16,620,000           | 1.26%          |
| FEDERAL HOME LOAN PC REMIC             | 9.15                | 10/15/20 | 85,633               | 84,804               | 85,487               | 0.01%          |
| FEDERAL AGRICULTURAL MORTGAGE CORP     | 6.71                | 07/28/14 | 8,000,000            | 8,850,869            | 8,617,368            | 0.66%          |
| FEDERAL FARM CREDIT BANKS              | 5.45                | 04/21/20 | 6,000,000            | 5,858,013            | 5,646,240            | 0.43%          |
| FEDERAL FARM CREDIT BANKS              | 5.20                | 12/27/12 | 4,000,000            | 4,000,000            | 3,913,960            | 0.30%          |
| FEDERAL HOME LOAN BANKS                | 4.25                | 07/17/13 | 7,000,000            | 6,593,920            | 6,465,256            | 0.49%          |
| FEDERAL HOME LOAN BANKS                | 6.40                | 06/03/14 | 6,000,000            | 5,695,156            | 6,314,890            | 0.48%          |
| FEDERAL HOME LOAN BANK                 | 7.00                | 08/26/19 | 7,000,000            | 6,967,799            | 7,842,765            | 0.60%          |
| FEDERAL HOME LOAN BANKS                | 7.45                | 02/03/20 | 10,000,000           | 10,055,590           | 11,770,130           | 0.90%          |
| FEDERAL HOME LOAN BANKS                | 4.13                | 08/13/10 | 15,000,000           | 15,128,379           | 14,264,145           | 1.09%          |
| FEDERAL HOME LOAN BANKS                | 5.00                | 08/28/19 | 10,000,000           | 10,000,000           | 9,787,000            | 0.74%          |
| FEDERAL HOME LOAN BANKS                | 5.00                | 05/26/10 | 5,000,000            | 5,000,000            | 4,919,575            | 0.37%          |
| FEDERAL NATIONAL MORTGAGE ASSOC        | 6.00                | 05/15/08 | 15,000,000           | 14,877,757           | 15,141,470           | 1.15%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 7.25                | 01/15/10 | 15,000,000           | 14,973,117           | 15,846,305           | 1.21%          |
| FEDERAL NATIONAL MORTGAGE ASSOC        | 4.50                | 08/15/08 | 10,000,000           | 10,000,000           | 9,808,810            | 0.75%          |
| FNMA POOL 254233                       | 5.00                | 03/01/17 | 5,567,419            | 5,422,222            | 5,383,216            | 0.41%          |
| FNMA POOL 254631                       | 5.00                | 02/01/18 | 6,743,426            | 6,774,409            | 6,509,444            | 0.50%          |
| FNMA POOL 256083                       | 6.00                | 01/01/26 | 23,661,358           | 23,573,185           | 23,505,927           | 1.79%          |
| FNMA POOL 303202                       | 6.50                | 05/01/14 | 893,810              | 888,099              | 903,285              | 0.07%          |
| FNMA POOL 313999                       | 6.00                | 02/01/13 | 326,389              | 325,314              | 327,702              | 0.02%          |
| FNMA POOL 572220                       | 6.00                | 03/01/16 | 716,958              | 715,437              | 720,403              | 0.05%          |
| FNMA POOL 592327                       | 5.50                | 06/01/16 | 1,022,557            | 1,004,743            | 1,005,900            | 0.08%          |
| FNMA POOL 725346                       | 4.00                | 03/01/19 | 15,128,277           | 14,988,010           | 13,984,118           | 1.06%          |
| FNMA POOL 745250                       | 5.00                | 01/01/21 | 19,123,097           | 19,041,512           | 18,423,182           | 1.40%          |
| FNMA POOL 780956                       | 4.50                | 05/01/19 | 15,154,883           | 15,150,744           | 14,342,785           | 1.09%          |
| FREDDIE MAC                            | 4.10                | 01/28/14 | 30,000,000           | 30,000,000           | 28,612,290           | 2.18%          |
| U S ARMY HOSPITALITY FUND              | 7.47                | 05/01/32 | 9,580,593            | 9,580,593            | 10,789,663           | 0.82%          |
| <b>U.S. Government Indirect-Backed</b> | <b>51 Issue(s)</b>  |          | <b>723,770,124</b>   | <b>518,980,161</b>   | <b>509,562,146</b>   | <b>38.76%</b>  |
| <b>Total TFBP</b>                      | <b>243 Issue(s)</b> |          | <b>1,588,492,464</b> | <b>1,323,175,351</b> | <b>1,314,596,488</b> | <b>100.00%</b> |



# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Short Term Investment Pool, as of June 30, 2006, and 2005, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Short Term Investment Pool, as of June 30, 2006, and 2005, and its changes in net asset value and investment income and distribution for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
SHORT TERM INVESTMENT POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2006 AND 2005

|                                                                                                                              | <u>2006</u>             | <u>2005</u>             |
|------------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| <u>Assets</u>                                                                                                                |                         |                         |
| Cash                                                                                                                         | \$ 800,401              | \$ 528,828              |
| Interest receivable                                                                                                          | 8,833,874               | 1,385,382               |
| Security lending cash collateral (Notes 3 and 4)                                                                             | 36,071,813              | 0                       |
| Unrealized loss (Note 2)                                                                                                     | 1,927,165               | 435,083                 |
| Investments managed at fair value (amortized cost of \$2,190,772,793 in 2006 and \$1,742,735,519 in 2005) (Notes 2, 4 and 8) | <u>2,188,845,628</u>    | <u>1,742,300,436</u>    |
| Total assets                                                                                                                 | \$ <u>2,236,478,881</u> | \$ <u>1,744,649,729</u> |
| <u>Liabilities</u>                                                                                                           |                         |                         |
| Security lending expense payable                                                                                             | \$ 103,751              | \$ 0                    |
| Income due participants                                                                                                      | 800,365                 | 528,829                 |
| Broker payable for securities purchases but not settled (Note 2)                                                             | 0                       | 3,000,000               |
| Security lending obligations(Notes 3 and 4)                                                                                  | <u>36,071,813</u>       | <u>0</u>                |
| Total liabilities                                                                                                            | \$ <u>36,975,929</u>    | \$ <u>3,528,829</u>     |
| Net asset value                                                                                                              | \$ <u>2,199,502,952</u> | \$ <u>1,741,120,900</u> |
| Units Outstanding (Note 2)                                                                                                   | 2,199,502,952           | 1,741,120,900           |
| Unit Value (Note 2)                                                                                                          | \$ 1                    | \$ 1                    |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                          |                         |                         |
|------------------------------------------|-------------------------|-------------------------|
| Net asset value, beginning of year       | \$ 1,741,120,900        | \$ 1,480,216,590        |
| Value of units purchased by participants | 6,986,836,660           | 6,123,148,064           |
| Value of units sold by participants      | <u>(6,528,454,608)</u>  | <u>(5,862,243,754)</u>  |
| Net asset value, end of year             | \$ <u>2,199,502,952</u> | \$ <u>1,741,120,900</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                            |                   |                   |
|--------------------------------------------|-------------------|-------------------|
| Investment income (Note 2)                 | \$ 78,852,488     | \$ 35,536,850     |
| Security lending income                    | 1,368,820         | 0                 |
| Security lending expense                   | (1,363,341)       | 0                 |
| Administrative expenses                    | (335,877)         | (260,729)         |
| Income due participants, beginning of year | <u>528,829</u>    | <u>203,236</u>    |
| Income available for distribution          | 79,050,919        | 35,479,357        |
| Distribution                               | <u>78,250,554</u> | <u>34,950,528</u> |
| Income due participants, end of year       | \$ <u>800,365</u> | \$ <u>528,829</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
SHORT TERM INVESTMENT POOL - NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

1. HISTORY AND ORGANIZATION

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Short Term Investment Pool (STIP) was created by the Board to allow qualifying funds, per sections 17-6-201, 202 and 204, MCA, to participate in a diversified pool. Although state agencies with accounts that retain their interest earnings are legally required to invest in STIP, local governments may voluntarily participate in STIP.

The purpose of STIP is the preservation of principal, while obtaining money market type returns and 24-hour liquidity. Funds may be invested for relatively short periods - one day or more - depending upon the participant's anticipated use of the funds. The investments and the income from STIP are owned by the participants, as they purchase units, and are managed on their behalf by the Board.

Although STIP is not registered with the Securities and Exchange Commission (SEC) as an investment company, the Board has as policy that STIP will, and does, operate in a manner consistent with the SEC's rule 2a7 of the Investment Company Act of 1940. In meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The STIP portfolio may include asset-backed securities, commercial paper, corporate and U.S. government direct-backed, U.S. government indirect-backed securities, repurchase agreements, and variable-rate (floating-rate) instruments. These securities are purchased to provide shareholders with a diversified portfolio earning a competitive total rate of return.

Asset-backed securities represent debt securities collateralized by a pool of mortgage and non-mortgage assets such as trade and loan receivables, equipment leases, credit cards, etc. Commercial paper is unsecured short-term debt with maturities ranging from 1 to 270 days. Commercial paper issued at a discount, direct or by brokers, is backed by bank credit lines. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. Repurchase agreements (REPOs) represent an agreement between a seller and a buyer, usually of U.S. government securities, whereby the seller agrees to repurchase the securities at an agreed upon price and stated time. Variable-rate (floating-rate) securities pay a variable rate of interest until maturity. The STIP portfolio's variable-rate securities float with LIBOR (London Interbank Offered Rate).

Investments held are reported at fair value as of June 30, based on market prices supplied to the Board by the Board's custodial bank. The difference between amortized cost and fair value is reflected as an unrealized gain or loss in the investments managed. The STIP investment portfolio consists of securities with a maximum maturity of 397 days or less with the exception of securities having rate reset dates. The portfolio is carried at amortized cost or book value.

Participant Units

The STIP unit value is fixed at \$1 for both participant buys and sells. A purchased unit earns income on the purchase date and ceases to earn income on the day before the unit is sold. Participants may buy or sell fractional shares. For fiscal years 2006 and 2005, income was distributed on the first calendar day of each month, with the exception of the June distribution. Income for June 2006 and June 2005 was distributed on the last calendar day of the month. Participants may automatically reinvest their income in additional units.

During fiscal years 2006 and 2005, the Board did not provide or obtain any legally binding guarantees to support the value of the participant units.

Broker Receivable/Payable

STIP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the STIP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

## Other

Administrative expenses incurred by the Board are charged daily to STIP based on the Board's expenses applicable to STIP.

### 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 102 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively, as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2006, the carrying and fair value of the underlying securities on loan, categorized as U.S. Government indirect-backed bonds, for the Short Term Investment Pool was \$35,271,669 and \$35,219,601 respectively. The collateral provided for the securities on loan totaled \$36,071,813 in cash. As of June 30, 2005, there were no securities on loan.

### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

#### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The STIP securities have credit risk as measured by major credit rating services. This risk is that the issuer of a STIP security may default in making timely principal and interest payments. The Board of Investment's policy requires that STIP securities have the highest investment grade rating in the short term category by at least one Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality per GASB Statement No. 40.

The short term credit ratings presented in the table below are provided by S& P's rating services. An A1+ rating is the highest short term rating by the S&P rating service. If a STIP security received a long term rating, such as AAA, this rating was converted to a short term rating. If an S&P rating is not available, a Moody's rating has been used.

#### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, all STIP securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. According to the STIP

Investment Policy, “repurchase agreements require electronic delivery of U.S. Government Treasury collateral, priced at 102 percent market value, to the designated State of Montana Federal Reserve Bank account.”

#### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government’s investment in a single issuer. The STIP Investment Policy Statement does not specifically address concentration of credit risk. The policy does provide for “minimum three (3%) percent or \$15 million, whichever is higher, to be invested in Repurchase Agreements.” The STIP had concentration of credit risk exposure to the Federal Home Loan Bank of 6.59% as of June 30, 2006. As of June 30, 2005, there were no single issuer investments that exceeded 5% of the STIP portfolio.

#### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. According to GASB Statement No. 40, “interest rate disclosures are not required for pooled investments if the pool is a 2a-7-like pool”. Operating as 2a-7 like pool, this exclusion applies to STIP.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

While variable-rate (floating-rate) securities have credit risk identical to similar fixed-rate securities, their interest rate risk is more sensitive to interest rate changes. However, their fair value may be less volatile than fixed-rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

STIP investments are categorized on the next page to disclose credit rate risk as of as of June 30, 2006 and June 30, 2005. Credit risk reflects the security quality rating, by investment security type, as of the June 30 report date. If a security investment type is unrated, the quality type is indicated by NR (not rated). Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated by the NRSRO.

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Credit Quality Ratings as of June 30, 2006

| <u>Security Investment Type</u>               |   | <u>Fair Value</u>    | <u>Credit<br/>Quality<br/>Rating</u> |
|-----------------------------------------------|---|----------------------|--------------------------------------|
| Commercial Paper                              | S | 1,421,008,799        | A1                                   |
| Corporate Fixed                               |   | 293,960,550          | A1+                                  |
| Corporate Variable-Rate                       |   | 224,991,750          | A1+                                  |
| U.S. Government Indirect-Backed               |   | <u>248,884,529</u>   | <u>A1+</u>                           |
| Total Investments                             | S | <u>2,188,845,628</u> | <u>A1+</u>                           |
| Securities Lending Collateral Investment Pool | S | <u>36,071,813</u>    | NR                                   |

Credit Quality Ratings as of June 30, 2005

| <u>Security Investment Type</u>               |   | <u>Fair Value</u>    | <u>Credit<br/>Quality<br/>Rating</u> |
|-----------------------------------------------|---|----------------------|--------------------------------------|
| Commercial Paper                              | S | 1,249,527,386        | A1                                   |
| Corporate Fixed                               |   | 49,821,250           | A1+                                  |
| Corporate Variable-Rate                       |   | 414,951,800          | A1+                                  |
| Municipal Variable-Rate                       |   | 6,000,000            | NR                                   |
| Repurchase Agreement*                         |   | <u>22,000,000</u>    | <u>A1+</u>                           |
| Total Investments                             | S | <u>1,742,300,436</u> | <u>A1+</u>                           |
| Securities Lending Collateral Investment Pool | S | <u>0</u>             | NR                                   |

\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at a fair value of \$22 million by a \$17.1 million par, 6.375% coupon, U.S. government Treasury bond maturing August 15, 2027.

Legal Risk

The Board is not aware of any legal risks regarding any STIP investments.

5. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Implementation of electronic trading for the Short Term Investment Pool and the other fixed income portfolios, as managed by Board Staff, was completed in fiscal year 2006.

6. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT download function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 7. SUBSEQUENT EVENT

On August 24, 2006, the Board approved a revised Investment Policy Statement for STIP. This policy defines objectives, authorized investments, and portfolio diversification and limitations.

## 8. YEAR END PORTFOLIO

The June 30, 2006 STIP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

| <u>Security Name</u>       | <u>Coupon</u> | <u>Maturity</u> | <u>Par</u> | <u>Book Value</u> | <u>Fair Value</u> | <u>%</u> |
|----------------------------|---------------|-----------------|------------|-------------------|-------------------|----------|
| ALTAMIRA FUNDING           | discount      | 08/03/06        | 40,000,000 | 39,803,833        | 39,798,800        | 1.82%    |
| ALTAMIRA FUNDING           | discount      | 08/03/06        | 30,000,000 | 29,852,325        | 29,849,100        | 1.36%    |
| ANGLO IRISH BANK           | discount      | 07/19/06        | 40,000,000 | 39,896,900        | 39,888,000        | 1.82%    |
| AQUINAS FUNDING LLC        | discount      | 07/20/06        | 40,000,000 | 39,891,489        | 39,881,600        | 1.82%    |
| ATOMIUM FUNDING CORP       | discount      | 08/02/06        | 30,463,000 | 30,318,402        | 30,314,036        | 1.38%    |
| BAVARIA TRR CORP           | discount      | 07/03/06        | 40,000,000 | 39,988,622        | 39,988,400        | 1.83%    |
| BEETHOVEN FUNDING CORP     | discount      | 07/12/06        | 40,000,000 | 39,937,911        | 39,928,800        | 1.82%    |
| BHP BILL FINANCE           | discount      | 07/14/06        | 35,000,000 | 34,935,794        | 34,927,200        | 1.60%    |
| BLACK DIAMOND USA          | discount      | 08/01/06        | 30,000,000 | 29,862,308        | 29,853,300        | 1.36%    |
| BUNGE ASSET FUNDING        | discount      | 07/10/06        | 37,258,000 | 37,210,682        | 37,208,074        | 1.70%    |
| CATAPULT PMX FUNDING LLC   | discount      | 07/14/06        | 40,000,000 | 39,925,467        | 39,916,800        | 1.82%    |
| CHARTA CORP                | discount      | 07/26/06        | 36,188,000 | 36,057,572        | 36,048,676        | 1.65%    |
| CHECK POINT CHARLIE        | discount      | 07/07/06        | 31,000,000 | 30,973,702        | 30,967,760        | 1.41%    |
| COBBLER FUNDING            | discount      | 07/25/06        | 35,420,000 | 35,296,502        | 35,288,946        | 1.61%    |
| COMPASS SECURITIES         | discount      | 07/24/06        | 18,295,000 | 18,234,454        | 18,224,564        | 0.83%    |
| DZ BK AG DEUTSCHE ZENTRAL  | discount      | 07/07/06        | 40,000,000 | 39,966,333        | 39,958,400        | 1.83%    |
| EAST FLEET FINANCE         | discount      | 07/24/06        | 28,633,000 | 28,535,497        | 28,522,763        | 1.30%    |
| FPL FUELS INC              | discount      | 07/31/06        | 22,725,000 | 22,626,146        | 22,646,826        | 1.03%    |
| GENERAL ELECTRIC CO        | discount      | 07/21/06        | 40,000,000 | 39,887,111        | 39,875,600        | 1.82%    |
| GOLDEN FISH                | discount      | 07/24/06        | 45,000,000 | 44,847,625        | 44,826,750        | 2.05%    |
| GOTHAM FUNDING CORP        | discount      | 07/06/06        | 40,000,000 | 39,971,611        | 39,964,400        | 1.83%    |
| ING U S FUNDING            | discount      | 07/27/06        | 40,000,000 | 39,849,778        | 39,840,000        | 1.82%    |
| IXIS CORP                  | discount      | 07/06/06        | 50,000,000 | 49,965,139        | 49,955,500        | 2.28%    |
| LIBERTY HARBOR             | discount      | 07/27/06        | 45,000,000 | 44,827,425        | 44,820,000        | 2.05%    |
| LIBERTY STREET FUNDING     | discount      | 07/03/06        | 40,000,000 | 39,988,844        | 39,988,400        | 1.83%    |
| MORRIGAN TRR FUNDING       | discount      | 07/28/06        | 40,000,000 | 39,841,900        | 39,834,000        | 1.82%    |
| NORTH SEA FUNDING EUROPE   | discount      | 07/25/06        | 20,117,000 | 20,046,993        | 20,042,567        | 0.92%    |
| OLD LINE FUNDING CORP      | discount      | 07/11/06        | 40,000,000 | 39,943,611        | 39,928,800        | 1.82%    |
| ORCHID FUNDING CORP        | discount      | 07/10/06        | 40,000,000 | 39,946,800        | 39,946,800        | 1.83%    |
| ORCHID FUNDING CORP        | discount      | 07/14/06        | 40,000,000 | 39,923,156        | 39,916,800        | 1.82%    |
| RHINELAND FUNDING CAPITAL  | discount      | 07/28/06        | 60,000,000 | 59,758,800        | 59,751,000        | 2.73%    |
| STARBIRD FUNDING CORP      | discount      | 07/31/06        | 20,000,000 | 19,913,500        | 19,911,200        | 0.91%    |
| SUNBELT FUNDING CORP       | discount      | 07/18/06        | 40,000,000 | 39,903,667        | 39,887,200        | 1.82%    |
| SYDNEY CAPITAL INC         | discount      | 07/19/06        | 40,000,000 | 39,898,400        | 39,887,600        | 1.82%    |
| THAMES ASSET GLOBAL        | discount      | 07/13/06        | 39,722,000 | 39,654,804        | 39,645,337        | 1.81%    |
| UBS FINANCE DELEWARE       | discount      | 07/17/06        | 60,000,000 | 59,864,133        | 59,857,800        | 2.73%    |
| WORLD OMNI VEHICLE LEASING | discount      | 07/05/06        | 40,000,000 | 39,977,422        | 39,970,400        | 1.83%    |

| <u>Security Name</u>                           | <u>Coupon</u> | <u>Maturity</u> | <u>Par</u>           | <u>Book Value</u>    | <u>Fair Value</u>    | <u>%</u>       |
|------------------------------------------------|---------------|-----------------|----------------------|----------------------|----------------------|----------------|
| WPS RESOURCES CORP                             | discount      | 07/12/06        | 30,000,000           | 29,951,142           | 29,946,600           | 1.37%          |
| <b>Commercial Paper</b>                        |               |                 | <b>1,424,821,000</b> | <b>1,421,275,801</b> | <b>1,421,008,799</b> | <b>64.92%</b>  |
| CULLINAN FINANCE                               | 5.000         | 02/26/07        | 25,000,000           | 25,000,000           | 24,861,750           | 1.14%          |
| CULLINAN FINANCE                               | 5.200         | 04/16/07        | 35,000,000           | 35,000,000           | 34,814,500           | 1.59%          |
| FIVE FINANCE INC                               | 5.700         | 06/28/07        | 40,000,000           | 40,000,000           | 39,979,200           | 1.83%          |
| HARRIER FINANCE FUNDING                        | 4.000         | 08/11/06        | 50,000,000           | 50,000,000           | 49,919,000           | 2.28%          |
| HBOS TREASURY SERVICES                         | 5.305         | 04/18/07        | 30,000,000           | 30,001,150           | 29,887,500           | 1.37%          |
| K2 USA                                         | 5.515         | 06/20/07        | 40,000,000           | 40,000,000           | 39,925,600           | 1.82%          |
| PREMIER ASSET                                  | 4.800         | 01/30/07        | 25,000,000           | 25,000,000           | 24,856,000           | 1.14%          |
| THETA CORP                                     | 4.913         | 02/02/07        | 50,000,000           | 50,000,000           | 49,717,000           | 2.27%          |
| <b>Corporate Fixed</b>                         |               |                 | <b>295,000,000</b>   | <b>295,001,150</b>   | <b>293,960,550</b>   | <b>13.43%</b>  |
| CHEYNE FINANCE                                 | 5.293         | 08/25/06        | 25,000,000           | 24,999,914           | 25,000,250           | 1.14%          |
| CHEYNE FINANCE                                 | 5.169         | 11/15/06        | 25,000,000           | 24,999,531           | 25,000,500           | 1.14%          |
| MERRILL LYNCH + CO INC                         | 5.149         | 05/14/07        | 25,000,000           | 25,000,000           | 24,998,000           | 1.14%          |
| PARKLAND USA L L C                             | 5.232         | 04/19/07        | 25,000,000           | 25,000,000           | 24,998,750           | 1.14%          |
| PARKLAND USA L L C                             | 5.232         | 05/22/07        | 25,000,000           | 24,998,887           | 24,995,000           | 1.14%          |
| PREMIER ASSET                                  | 5.159         | 09/15/06        | 25,000,000           | 24,999,479           | 25,000,250           | 1.14%          |
| SIGMA FINANCE                                  | 5.222         | 04/26/07        | 25,000,000           | 25,000,000           | 24,997,750           | 1.14%          |
| STANFIELD VICTORIA FINANCE                     | 5.089         | 07/31/06        | 25,000,000           | 24,999,620           | 25,000,500           | 1.14%          |
| STANFIELD VICTORIA FINANCE                     | 5.064         | 09/01/06        | 25,000,000           | 24,999,363           | 25,000,750           | 1.14%          |
| <b>Corporate Variable-Rate (Floating Rate)</b> |               |                 | <b>225,000,000</b>   | <b>224,996,794</b>   | <b>224,991,750</b>   | <b>10.28%</b>  |
| FEDERAL HOME LOAN BANK                         | 4.000         | 09/26/06        | 20,000,000           | 19,987,217           | 19,932,514           | 0.91%          |
| FEDERAL HOME LOAN BANK                         | 2.750         | 10/15/06        | 25,000,000           | 24,829,460           | 24,801,710           | 1.13%          |
| FEDERAL HOME LOAN BANK                         | 5.000         | 12/22/06        | 25,000,000           | 25,000,000           | 24,926,845           | 1.14%          |
| FEDERAL HOME LOAN BANK                         | 4.625         | 01/23/07        | 25,000,000           | 24,983,837           | 24,865,608           | 1.14%          |
| FEDERAL HOME LOAN BANK                         | 5.000         | 02/09/07        | 25,000,000           | 25,000,000           | 24,892,253           | 1.14%          |
| FEDERAL HOME LOAN BANK                         | 5.000         | 03/13/07        | 25,000,000           | 24,977,500           | 24,901,205           | 1.14%          |
| FEDERAL NATIONAL MORTGAGE                      | 4.000         | 08/08/06        | 50,000,000           | 50,000,000           | 49,929,780           | 2.28%          |
| FEDERAL NATIONAL MORTGAGE                      | 4.000         | 08/22/06        | 25,000,000           | 24,998,114           | 24,953,755           | 1.14%          |
| FEDERAL NATIONAL MORTGAGE                      | 2.625         | 11/15/06        | 30,000,000           | 29,722,919           | 29,680,860           | 1.36%          |
| <b>U.S. Government Indirect-Backed</b>         |               |                 | <b>250,000,000</b>   | <b>249,499,047</b>   | <b>248,884,529</b>   | <b>11.37%</b>  |
| <b>Total STIP</b>                              |               |                 | <b>2,194,821,000</b> | <b>2,190,772,793</b> | <b>2,188,845,628</b> | <b>100.00%</b> |



# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Domestic Equity Pool, as of June 30, 2006, and 2005, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Domestic Equity Pool, as of June 30, 2006, and 2005, and its changes in net asset value and investment income and distribution for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA DOMESTIC EQUITY POOL FINANCIAL STATEMENTS  
STATEMENT OF NET ASSET VALUE JUNE 30, 2006 AND 2005

| <u>Assets</u>                                                                                                               | <u>2006</u>             | <u>2005</u>             |
|-----------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| Cash                                                                                                                        | \$ 0                    | \$ 0                    |
| Security lending cash collateral (Notes 3 and 4)                                                                            | 12,879,680              | 28,995,031              |
| Dividend receivable                                                                                                         | 1,380,655               | 1,472,227               |
| Interest receivable                                                                                                         | 3,267,046               | 92,951                  |
| Investments managed at fair value (carrying value of \$2,700,870,570 in 2006 and \$2,609,202,578 in 2005)(Notes 2, 4 and 8) | <u>3,152,703,754</u>    | <u>3,011,913,931</u>    |
| Total assets                                                                                                                | \$ <u>3,170,231,135</u> | \$ <u>3,042,474,140</u> |
| <u>Liabilities</u>                                                                                                          |                         |                         |
| Income due participants                                                                                                     | \$ 1,726,250            | \$ 1,988,934            |
| Broker payable for securities purchased but not settled (Note 2)                                                            | 2,941,532               | 0                       |
| Security lending expense payable                                                                                            | 23,669                  | 88,165                  |
| Security lending obligations (Notes 3 and 4)                                                                                | <u>12,879,680</u>       | <u>28,995,031</u>       |
| Total liabilities                                                                                                           | <u>17,571,131</u>       | <u>31,072,130</u>       |
| Net asset value                                                                                                             | \$ <u>3,152,660,004</u> | \$ <u>3,011,402,010</u> |
| Units Outstanding (Note2)                                                                                                   | 22,843,210              | 23,404,482              |
| Unit Value (Note 2)                                                                                                         | \$ 138.01               | \$ 128.67               |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                                        |                         |                         |
|--------------------------------------------------------|-------------------------|-------------------------|
| Net asset value, beginning of year                     | \$ 3,011,402,010        | \$ 2,901,726,047        |
| Value of MDEP units purchased by participants (Note 2) | 2,119,999               | 599,999                 |
| Value of MDEP units sold by participants (Note 2)      | (38,737,365)            | (13,396,698)            |
| Changes in fair value of investments managed (Note 2)  | <u>177,875,360</u>      | <u>122,472,662</u>      |
| Net asset value, end of year                           | \$ <u>3,152,660,004</u> | \$ <u>3,011,402,010</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                            |                     |                     |
|--------------------------------------------|---------------------|---------------------|
| Investment income (Note 2)                 | \$ 27,960,398       | \$ 39,004,072       |
| Security lending income                    | 1,304,971           | 560,697             |
| Security lending expense                   | (1,265,940)         | (531,967)           |
| Administrative expenses (Note 2)           | (2,312,898)         | (2,460,957)         |
| Income due participants, beginning of year | <u>1,988,934</u>    | <u>2,611,096</u>    |
| Income available for distribution          | 27,675,465          | 39,182,941          |
| Distribution (Note 2)                      | <u>25,949,216</u>   | <u>37,194,007</u>   |
| Income due participants, end of year       | \$ <u>1,726,249</u> | \$ <u>1,988,934</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA DOMESTIC EQUITY - NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

**1. HISTORY AND ORGANIZATION**

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Montana Common Stock Pool (MTCP) was created by the Board to allow retirement and endowment funds, per section 17-6-201, MCA, the opportunity to participate in the equity market via a diversified pool. MTCP was created as of July 1, 1980, by the transfer of all common stock owned by the Public Employees' Retirement System, Teachers' Retirement System, and other funds into MTCP.

In March 1996, the Board approved the Investment Policy Statement to reflect the name change from the Montana Common Stock Pool to the Montana Stock Pool. The Montana Stock Pool is referred to as "Montcomp" or MTCP. This policy statement provided for the investment in common or preferred stock. The Investment Policy Statement has been subsequently revised and approved to allow investment in the following security types:

|                |                                                        |
|----------------|--------------------------------------------------------|
| September 1996 | Securities convertible into common or preferred stocks |
| June 2000      | Equity derivatives                                     |
| January 2004   | American Depositary Receipts (ADR's)                   |

The Board authorized creation of the Montana Domestic Equity Pool (MDEP) in April 2003. Effective May 1, 2003, the pool combined the investments of the Montana Stock Pool (MTCP), Barclays Global Investors (BGI) and Dimensional Fund Advisors (DFA). The nine pension funds transferred \$740 million, at cost, of BGI S&P 500 Equity Index investments and DFA Small Cap investments from the All Other Funds portfolio to the MDEP. At the same time, all pension and endowment fund MTCP participants exchanged their MTCP investment for MDEP shares.

There are currently nine separate managers investing funds within the MDEP. The date each manager was first funded, the fair value of each portfolio as of June 30, 2006, and the percent of the MDEP total is shown in the table below:

| <u>Investment Manager</u>                  | <u>Funding Date</u> | <u>June 30, 2006</u><br><u>Fair Value</u> | <u>% of Total</u>     |
|--------------------------------------------|---------------------|-------------------------------------------|-----------------------|
| Internal Actively Managed (MTCP)           | July 1980           | \$ 1,058,743,931                          | 33.58%                |
| Barclays Global Large Cap* Passive Index   | April 2000          | 1,178,260,318                             | 37.37%                |
| Dimensional Fund Small Cap* Enhanced Index | January 2003        | 213,902,449                               | 6.78%                 |
| Barclays Global Mid Cap* Passive Index     | December 2004       | 191,367,605                               | 6.07%                 |
| Western Asset Large Cap* Enhanced Index    | June 2006           | 125,424,632                               | 3.98%                 |
| T Rowe Price Large Cap* Enhanced Index     | June 2006           | 124,491,529                               | 3.95%                 |
| Goldman Sachs Large Cap* Enhanced Index    | June 2006           | 124,463,571                               | 3.95%                 |
| INTECH Large Cap* Enhanced Index           | June 2006           | 124,358,200                               | 3.94%                 |
| State Street Bank SPIFF (MDEP)             | July 2003           | <u>11,691,519</u>                         | <u>0.37%</u>          |
| <b>Total MDEP</b>                          |                     | <b>\$ <u>3,152,703,754</u></b>            | <b><u>100.00%</u></b> |

\* Market capitalization "Cap" refers to the value of a corporation as determined by the market price of its issued and outstanding common stock.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Investments

MDEP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The MDEP portfolio may include common stock, equity index, preferred stock, convertible equity securities, American Depositary Receipts (ADR's) and equity derivatives. Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters as well as receive dividends on their holdings if the company chooses to pay dividends. Equity index investments are investments in selected mutual funds whose equity portfolios match a broad based index or specific industry composite. Preferred stock, as a class of stock, pays dividends at a specified rate and has preference in the payment of dividends and liquidation of assets.

Preferred stock holders, ordinarily, do not have voting rights. Convertible securities are securities carrying the right to exchange, or "convert" the instrument for other securities of the issuer or of another issuer. This definition most often applies to preferred stocks or corporate bonds carrying the right to exchange for a fixed number of shares of the issuer's common stock. ADR's are receipts issued by a US depository bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depository bank. Equity derivatives, such as futures and options, "derive" their value from underlying equity instruments.

In June 2000, the Board approved the securitization of MTCP cash by investing in an equity derivative, the State Street Stock Performance Index Futures Fund (SPIFF). Portfolio cash is swept daily into SPIFF maintaining 100% equity exposure through holdings of stock index futures. As of June 30, 2006, MTCP cash was invested in the custodial bank's Short Term Investment Fund (STIF). As of June 30, 2005, MTCP cash was invested in SPIFF.

As a liquidity option, the Board approved investment by MTCP in Board's Short Term Investment Pool (STIP) in October 2004. STIP, as an external investment pool, commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values. Since Board approval, no MTCP cash has been invested in STIP.

The MDEP, as an internal investment pool, invested its excess cash, on pool creation, in STIP. In July 2003, the STIP account was closed and a SPIFF account was opened to securitize MDEP cash by investing in an equity derivative.

On April 26, 2006, the Board approved the staff recommendation to hire four enhanced index equity managers for the MDEP. In implementing this recommendation, the Board transferred over 12.2 million shares in 134 positions held in MTCP to the State Street Transition Account on May 26, 2006. The MDEP sold 1,280,708 MTCP units at a gain of \$311,863,123 for shares valued at \$449,738,960 in the Transition Account. From the Transition Account, Goldman Sachs, Enhanced Investment Technology (INTECH), T. Rowe Price and Western Asset Management (WAMCO) were funded, each, approximately \$125 million in cash and shares of stock. The exact funding amounts, by manager, are listed as by Carrying Value in Note 4.

In February 2005, as directed by the Board to rebalance the MDEP portfolio, staff exchanged 893,504 MTCP units at a gain of \$207,282,346 for shares valued at \$338,356,609 in the BGI US Equity Restructure Account. The Restructure Account was closed and shares were transferred to the BGI S&P 500 Equity Index Account Fund A at a loss of \$2,822,974. This rebalancing transaction represented the transfer of over 8.4 million shares in 114 positions held in MTCP. Subsequent sales of MTCP units for \$160 million generated MDEP realized gains of \$97.3 million. MTCP sale proceeds were invested in the BGI S&P 500 Equity Index Account Fund A.

In fiscal year 2006, the MDEP sold \$50 million in the BGI Equity Index fund and recorded a net gain of \$5.7 million.

Other MDEP rebalancing actions in fiscal years 2006 and 2005 included the \$65 million and \$110 million sales of DFA Small Cap Subtrust shares. These sales resulted in MDEP realized gains of \$21.7 million and \$27.2 million, respectively.

Investments are presented in the Statement of Net Asset Value at fair value. Equity investments, on valuation date, are stated at the closing price of the security's primary exchange. Carrying value, parenthetically disclosed, represents the equity security purchase price plus a fixed commission where applicable.

#### Participant Units

The Public Employees' Retirement System and the Teachers' Retirement System transferred all stock owned into MTCP at the start-up date and were issued units according to the fair value of their contribution, retaining their original total cost basis. The initial unit value as of July 1, 1980, was \$1,000. Unit values thereafter and until March 31, 2000 were calculated weekly and at the close of the last business day of the month, based on the fair value of MTCP equity holdings and other assets. Effective April 1, 2000, the unit values are calculated daily. Daily unit value calculations were discontinued as of January 1, 2003. Since January 2003, MTCP unit values are calculated weekly and at the close of the last business day of the month. Depending on stock market conditions and the investment officer's decision, MDEP participants may then buy or sell units on the first calendar day of each month based on the month end values.

On July 1, 1994, the initial unit value changed from \$1,000 to \$100. This change was required for the Board's new accounting system. On August 17, 2000, shareholders, on record, received one MTCP share for each MTCP share held as the result of a 2:1 split. The unit value on August 31, 2000, prior to the split, was \$1,014 while the unit value, after the split, was \$507.

On May 1, 2003, the pension funds transferred all the BGI S&P 500 Equity Index Fund A and the DFA Small Cap Subtrust investments, at cost, to the MDEP. On the same date, the pension and endowment funds transferred their MTCP investments, at cost, to the MDEP. The pension and endowment funds were issued units according to the fair value of each participant's portfolio. The initial MDEP unit value on May 1, 2003 was \$100. On conversion date, MTCP participants exchanged approximately 5.8 million MTCP units, valued at \$302 per unit, for 24.1 million MDEP units, issued at \$100 per unit.

As reported in the Statement of Changes in Net Asset Value, the value of MDEP units purchased and sold by participants in fiscal years 2006 and 2005 are the result of asset allocation decisions and pool participant's cash needs. The fiscal year 2006 Change in Fair Value of Investments Managed of \$177.9 million reflects equity market depreciation of \$(134.7) million, participant gain distribution of \$(41.5) million and net pool realized gains of \$354.0 million. The fiscal year 2005 Change in Fair Value of Investments Managed of \$122.5 million represents equity market depreciation of \$(196.1) million, participant gain distribution of \$(12.7) million and net pool realized gains of \$331.3 million.

#### Broker Receivable/Payable

MDEP security transactions are recorded as of trade date rather than settlement date. Because of this generally accepted practice, the MDEP portfolio at June 30 may include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

#### Other

Investment income reported in the Statement of Investment Income and Distribution includes dividend accruals, tax reclaim accruals, SPIFF gain/losses and miscellaneous income. MDEP dividends are recorded on the ex-dividend date.

The MDEP Income Available for Distribution is distributed as of the first calendar day of each month. Administrative expenses incurred by the Board are charged daily to MDEP based on the Board's expenses applicable to MDEP. For fiscal years 2006 and 2005, these expenses include \$1,342,097 and \$1,313,197, respectively, for the Board and the custodial bank contract and \$970,801 and \$1,147,760, respectively, in external manager fees.

### 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 102 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received US dollar currency cash, US government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively, as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2006, the carrying and fair values of the underlying securities on loan of the MTCP for the MDEP were \$11,974,345 and \$12,629,239 respectively. The collateral provided for the securities on loan totaled \$12,879,680 in cash.

As of June 30, 2005, the carrying and fair values of the underlying securities on loan of the MTCP for the MDEP were \$28,062,757 and \$28,402,082 respectively. The collateral provided for the securities on loan totaled \$28,995,031 in cash.

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, securities held by the separate domestic account managers are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The BGI S&P 500 Equity Index Fund A, S&P 400 MidCap Equity Index Fund, DFA Small Cap Subtrust, Goldman Sachs and Western Asset (WAMCO) commingled funds are registered in the name of the Montana Board of Investments.

##### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments in pooled investments, such as the BGI Equity Index, Goldman Sachs, Western Asset (WAMCO) and DFA Small Cap Subtrust investments, are excluded from this requirement. As of June 30, 2006 and 2005, there were no single issuer investments that exceeded 5% of the MDEP portfolio.

The MDEP investments are disclosed by investment type in the following table and in Note 8 Year End Portfolio for 2006.

| <u>Security Investment Type</u>               | <u>2006</u>             |                         | <u>2005</u>             |                         |
|-----------------------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|                                               | <u>Carrying Amount</u>  | <u>Fair Value</u>       | <u>Carrying Amount</u>  | <u>Fair Value</u>       |
| Montana Stock Pool (MTCP)*                    | \$ 893,589,136          | \$ 1,058,743,931        | \$ 1,272,375,618        | \$ 1,509,202,412        |
| INTECH Large Cap Enhanced Index               | 123,837,189             | 124,358,200             | 0                       | 0                       |
| T Rowe Price Large Cap Enhanced Index         | <u>124,602,795</u>      | <u>124,491,529</u>      | <u>0</u>                | <u>0</u>                |
| Total Separate Domestic Accounts              | 1,142,029,120           | 1,307,593,660           | 1,272,375,618           | 1,509,202,412           |
| Goldman Sachs Large Cap Enhanced Index        | 125,956,387             | 124,463,571             | 0                       | 0                       |
| WAMCO Large Cap Enhanced Index US Index Plus  | 126,937,301             | 125,424,632             | 0                       | 0                       |
| BGI S&P 500 Passive Equity Index Fund         | 995,420,725             | 1,178,260,318           | 1,039,695,685           | 1,132,427,186           |
| DFA Small Cap Subtrust                        | 133,993,753             | 213,902,449             | 177,282,131             | 243,808,328             |
| BGI S&P 400 MidCap Passive Equity Index Fund  | 165,000,000             | 191,367,605             | 100,000,000             | 106,616,769             |
| MDEP Equity Futures (SPIFF)*                  | <u>11,533,284</u>       | <u>11,691,519</u>       | <u>19,849,144</u>       | <u>19,859,236</u>       |
| Total Investment                              | \$ <u>2,700,870,570</u> | \$ <u>3,152,703,754</u> | \$ <u>2,609,202,578</u> | \$ <u>3,011,913,931</u> |
| Securities Lending Collateral Investment Pool | \$ <u>12,879,680</u>    | \$ <u>12,879,680</u>    | \$ <u>28,995,031</u>    | \$ <u>28,995,031</u>    |

\* The Montana Stock Pool (MTCP) Carrying and Fair Value amounts for fiscal year 2005 have been restated to include the MTCP SPIFF Equity Futures Carrying and Fair Value amounts of \$7,518,437 and \$7,476,150, respectively. The Montana Stock Pool (MTCP) Carrying and Fair Values were previously reported as \$1,264,857,181 and \$1,501,726,262. The MDEP Equity Futures (SPIFF) amounts have been correspondingly reduced by the Carrying and Fair Value of the SPIFF as invested in MTCP. The SPIFF Carrying and Fair Value investments were previously reported as \$27,367,581 and \$527,335,386, respectively.

#### 5. OWENS-CORNING COMPLAINT

On October 11, 2002, the Board received a summons and complaint regarding the bankruptcy of Owens-Corning. The company seeks a determination that the dividend payments paid from October 1996 through July 2000 represent "fraudulent transfers under Chapter 11 Bankruptcy provisions and applicable state law, and are, therefore, voidable". The complaint states the Montana Board of Investments was the "recipient of dividends in the amount of \$357,099 for the relevant period". The Board has prepared a response to the complaint. As of September 22, 2006, this matter is still pending.

#### 6. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg

Financial Network Services for many years and already leased the hardware required to implement the trading system.

Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Implementation of electronic trading for the Short Term Investment Pool and the other fixed income portfolios, as managed by Board Staff, was completed in fiscal year 2006.

## 7. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT download function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 8. YEAREND PORTFOLIO

The June 30, 2006 MDEP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

| <u>Security Name</u>             | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|----------------------------------|---------------|-----------------------|-------------------|----------|
| GENERAL ELECTRIC CO              | 2,017,700     | 52,075,001            | 66,503,392        | 2.11%    |
| EXXON MOBIL CORP                 | 746,500       | 26,147,045            | 45,797,775        | 1.45%    |
| CITIGROUP INC                    | 813,900       | 16,805,288            | 39,262,536        | 1.25%    |
| JOHNSON + JOHNSON                | 538,500       | 13,828,997            | 32,266,920        | 1.02%    |
| BANK AMERICA CORP                | 605,700       | 24,546,214            | 29,134,170        | 0.92%    |
| PROCTER AND GAMBLE CO            | 491,300       | 24,408,273            | 27,316,280        | 0.87%    |
| JPMORGAN CHASE + CO              | 642,600       | 23,102,449            | 26,989,200        | 0.86%    |
| MICROSOFT CORP                   | 1,155,700     | 36,145,172            | 26,927,810        | 0.85%    |
| ALTRIA GROUP INC                 | 331,100       | 16,202,312            | 24,312,673        | 0.77%    |
| PFIZER INC                       | 950,500       | 34,854,859            | 22,308,235        | 0.71%    |
| WELLS FARGO + CO                 | 325,300       | 6,831,528             | 21,821,124        | 0.69%    |
| WAL MART STORES INC              | 421,300       | 20,971,261            | 20,294,021        | 0.64%    |
| AMERICAN INTERNATIONAL GROUP INC | 337,900       | 18,085,995            | 19,952,995        | 0.63%    |
| UNITED TECHNOLOGIES CORP         | 285,100       | 5,423,444             | 18,081,042        | 0.57%    |
| PEPSICO INC                      | 290,300       | 14,681,641            | 17,429,612        | 0.55%    |
| GOOGLE INC                       | 41,500        | 15,921,403            | 17,402,195        | 0.55%    |
| CHEVRON CORP                     | 279,200       | 10,884,499            | 17,327,152        | 0.55%    |
| AMGEN INC                        | 250,000       | 15,498,439            | 16,307,500        | 0.52%    |
| INTERNATIONAL BUSINESS MACHINES  | 207,400       | 10,045,791            | 15,932,468        | 0.51%    |
| CISCO SYSTEMS INC                | 781,000       | 11,895,592            | 15,252,930        | 0.48%    |
| SCHLUMBERGER LTD                 | 228,900       | 7,588,860             | 14,903,679        | 0.47%    |
| UNITED HEALTH GROUP INC          | 317,600       | 12,972,264            | 14,222,128        | 0.45%    |
| CONOCOPHILLIPS                   | 209,200       | 9,062,155             | 13,708,876        | 0.43%    |
| AT+T INC                         | 481,100       | 12,717,080            | 13,417,879        | 0.43%    |
| UNITED PARCEL SERVICE INC        | 161,600       | 11,486,243            | 13,304,528        | 0.42%    |
| ABBOTT LABS                      | 303,500       | 3,241,906             | 13,235,635        | 0.42%    |
| LILLY ELI + CO                   | 233,000       | 13,582,862            | 12,877,910        | 0.41%    |
| ORACLE CORP                      | 836,100       | 11,942,458            | 12,115,089        | 0.38%    |
| COCA COLA CO                     | 279,300       | 12,836,892            | 12,015,486        | 0.38%    |
| MOTOROLA INC                     | 594,400       | 11,068,348            | 11,977,160        | 0.38%    |
| TEXAS INSTRUMENTS INC            | 387,100       | 14,446,734            | 11,725,259        | 0.37%    |
| INTEL CORP                       | 602,200       | 6,113,233             | 11,411,690        | 0.36%    |
| APPLE COMPUTER                   | 185,200       | 7,707,746             | 10,578,624        | 0.34%    |
| QUALCOMM INC                     | 263,700       | 9,072,919             | 10,566,459        | 0.34%    |

| <u>Security Name</u>            | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|---------------------------------|---------------|-----------------------|-------------------|----------|
| MERRILL LYNCH + CO INC          | 147,000       | 8,516,993             | 10,225,320        | 0.32%    |
| TARGET CORP                     | 209,000       | 10,056,557            | 10,213,830        | 0.32%    |
| HOME DEPOT INC                  | 283,700       | 10,890,846            | 10,153,623        | 0.32%    |
| TYCO INTERNATIONAL LTD          | 369,000       | 10,176,737            | 10,147,500        | 0.32%    |
| 3M CO                           | 121,500       | 7,672,544             | 9,813,555         | 0.31%    |
| MORGAN STANLEY                  | 152,900       | 7,865,260             | 9,664,809         | 0.31%    |
| COMCAST CORP                    | 292,700       | 7,962,338             | 9,582,998         | 0.30%    |
| WYETH                           | 215,500       | 11,893,002            | 9,570,355         | 0.30%    |
| MEDTRONIC INC                   | 193,500       | 9,085,139             | 9,079,020         | 0.29%    |
| HEWLETT PACKARD CO              | 284,900       | 6,118,098             | 9,025,632         | 0.29%    |
| TRANSOCEAN INC                  | 110,600       | 5,932,005             | 8,883,392         | 0.28%    |
| BANK NEW YORK INC               | 270,600       | 9,845,333             | 8,713,320         | 0.28%    |
| DISNEY WALT CO                  | 278,900       | 8,212,946             | 8,367,000         | 0.27%    |
| AMERICAN EXPRESS CO             | 156,100       | 5,638,909             | 8,307,642         | 0.26%    |
| HALLIBURTON CO                  | 111,600       | 3,423,028             | 8,281,836         | 0.26%    |
| BOEING CO                       | 98,900        | 8,595,697             | 8,100,899         | 0.26%    |
| SLM CORP                        | 149,100       | 8,182,649             | 7,890,372         | 0.25%    |
| DELL INC                        | 308,700       | 10,764,373            | 7,535,367         | 0.24%    |
| YAHOO INC                       | 227,800       | 7,222,748             | 7,517,400         | 0.24%    |
| TIME WARNER INC                 | 425,300       | 12,655,475            | 7,357,690         | 0.23%    |
| BEST BUY CO INC                 | 133,700       | 5,126,451             | 7,332,108         | 0.23%    |
| HONEYWELL INTERNATIONAL INC     | 175,000       | 7,098,533             | 7,052,500         | 0.22%    |
| ZIMMER HOLDINGS INC             | 121,900       | 8,586,671             | 6,914,168         | 0.22%    |
| WELLPOINT INC                   | 94,200        | 6,501,958             | 6,854,934         | 0.22%    |
| GOLDMAN SACHS GROUP INC         | 43,100        | 4,531,616             | 6,483,533         | 0.21%    |
| WACHOVIA CORP                   | 119,700       | 4,485,964             | 6,473,376         | 0.21%    |
| NATIONAL OILWELL VARCO INC      | 97,400        | 6,175,893             | 6,167,368         | 0.20%    |
| DEVON ENERGY CORPORATION        | 101,400       | 6,221,513             | 6,125,574         | 0.19%    |
| AFLAC INC                       | 129,300       | 5,952,836             | 5,993,055         | 0.19%    |
| FEDERAL NATIONAL MORTGAGE ASSN  | 124,000       | 7,465,182             | 5,964,400         | 0.19%    |
| CAREMARK RX INC                 | 117,800       | 4,057,550             | 5,874,686         | 0.19%    |
| NII HOLDINGS INC                | 102,000       | 4,954,844             | 5,750,760         | 0.18%    |
| ADOBE SYSTEMS INC               | 187,700       | 6,813,369             | 5,698,572         | 0.18%    |
| GENENTECH INC                   | 69,200        | 5,838,414             | 5,660,560         | 0.18%    |
| MONSANTO CO                     | 66,500        | 4,304,969             | 5,598,635         | 0.18%    |
| EMC CORP                        | 507,400       | 8,227,139             | 5,566,178         | 0.18%    |
| VERIZON COMMUNICATIONS          | 161,900       | 4,961,593             | 5,422,031         | 0.17%    |
| US BANCORP                      | 175,300       | 5,057,390             | 5,413,264         | 0.17%    |
| CAPITAL ONE FINANCIAL CORP      | 62,200        | 5,127,219             | 5,314,990         | 0.17%    |
| MELLON FINANCIAL CORP           | 152,400       | 6,254,847             | 5,247,132         | 0.17%    |
| THE ST PAUL TRAVELERS COS INC   | 117,700       | 5,026,452             | 5,247,066         | 0.17%    |
| WRIGLEY WM JR CO                | 114,500       | 6,090,530             | 5,193,720         | 0.16%    |
| AETNA INC                       | 128,500       | 4,910,864             | 5,131,005         | 0.16%    |
| APACHE CORP                     | 75,100        | 4,746,770             | 5,125,575         | 0.16%    |
| CORNING INC                     | 210,300       | 5,545,132             | 5,087,157         | 0.16%    |
| WALGREEN CO                     | 108,800       | 3,474,374             | 4,878,592         | 0.15%    |
| GILEAD SCIENCES INC             | 82,200        | 4,934,383             | 4,862,952         | 0.15%    |
| FEDERAL HOME LOAN MORTGAGE CORP | 85,000        | 4,570,496             | 4,845,850         | 0.15%    |
| LOWES COS INC                   | 79,000        | 4,970,418             | 4,792,930         | 0.15%    |
| ANALOG DEVICES INC              | 148,600       | 5,616,138             | 4,776,004         | 0.15%    |
| BED BATH + BEYOND INC           | 143,600       | 5,343,548             | 4,763,212         | 0.15%    |
| SPRINT NEXTEL CORP              | 237,600       | 5,231,881             | 4,749,624         | 0.15%    |
| EBAY INC                        | 160,600       | 6,368,972             | 4,703,974         | 0.15%    |
| MAXIM INTEGRATED PRODUCTS INC   | 146,400       | 5,621,624             | 4,700,904         | 0.15%    |
| SYSCO CORP                      | 152,100       | 4,838,579             | 4,648,176         | 0.15%    |
| ALLTEL CORP                     | 72,400        | 4,420,598             | 4,621,292         | 0.15%    |
| NEWS CORP                       | 238,700       | 4,132,248             | 4,578,266         | 0.15%    |
| CVS CORP                        | 148,500       | 3,999,715             | 4,558,950         | 0.14%    |
| EMERSON ELEC CO                 | 51,800        | 2,029,049             | 4,341,358         | 0.14%    |
| BRISTOL MYERS SQUIBB CO         | 165,700       | 5,809,666             | 4,285,002         | 0.14%    |
| GLOBAL SANTA FE CORPORATION     | 74,000        | 4,371,925             | 4,273,500         | 0.14%    |
| VIACOM INC                      | 116,600       | 5,085,026             | 4,178,944         | 0.13%    |
| SAP AKTIENGESELLSCHAFT          | 76,000        | 3,754,303             | 3,991,520         | 0.13%    |

| <u>Security Name</u>            | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|---------------------------------|---------------|-----------------------|-------------------|----------|
| NOKIA CORP                      | 191,300       | 4,032,383             | 3,875,738         | 0.12%    |
| ALLERGAN INC                    | 34,200        | 3,240,644             | 3,668,292         | 0.12%    |
| CENDANT CORP                    | 219,300       | 3,832,908             | 3,572,397         | 0.11%    |
| APPLIED MATERIALS INC           | 207,100       | 3,184,109             | 3,371,588         | 0.11%    |
| ACCENTURE LTD                   | 117,500       | 3,050,086             | 3,327,600         | 0.11%    |
| STARBUCKS CORP                  | 87,500        | 3,113,705             | 3,304,000         | 0.10%    |
| TEXTRON INC                     | 35,500        | 3,305,985             | 3,272,390         | 0.10%    |
| NIKE INC                        | 38,700        | 3,260,971             | 3,134,700         | 0.10%    |
| STRYKER CORP                    | 73,300        | 3,358,542             | 3,086,663         | 0.10%    |
| PAYCHEX INC                     | 78,400        | 2,929,239             | 3,056,032         | 0.10%    |
| AMBAC FINANCIAL GROUP INC       | 37,400        | 2,952,888             | 3,033,140         | 0.10%    |
| FORTUNE BRANDS INC              | 42,600        | 2,235,337             | 3,025,026         | 0.10%    |
| AUTOMATIC DATA PROCESSING INC   | 66,200        | 2,974,143             | 3,002,170         | 0.10%    |
| DU PONT E I DE NEMOURS + CO     | 71,200        | 2,810,195             | 2,961,920         | 0.09%    |
| COSTCO WHOLESALE CORP           | 51,500        | 2,796,733             | 2,942,195         | 0.09%    |
| WILLIAMS COS INC                | 120,100       | 2,510,907             | 2,805,536         | 0.09%    |
| AUTODESK INCORPORATED           | 80,100        | 3,026,178             | 2,760,246         | 0.09%    |
| AIR PRODS + CHEMS INC           | 41,000        | 2,020,915             | 2,620,720         | 0.08%    |
| FRANKLIN RES INC                | 28,900        | 2,550,986             | 2,508,809         | 0.08%    |
| STAPLES INC                     | 99,100        | 2,382,715             | 2,410,112         | 0.08%    |
| CARNIVAL CORP                   | 54,500        | 2,570,518             | 2,274,830         | 0.07%    |
| EXPRESS SCRIPTS INC             | 30,600        | 2,269,175             | 2,195,244         | 0.07%    |
| JUNIPER NETWORKS INC            | 132,000       | 2,107,078             | 2,110,680         | 0.07%    |
| DAVITA INC                      | 41,000        | 2,055,798             | 2,037,700         | 0.06%    |
| HERSHEY CO                      | 36,000        | 2,041,176             | 1,982,520         | 0.06%    |
| CELGENE CORP                    | 41,000        | 1,637,081             | 1,944,630         | 0.06%    |
| MCDONALDS CORP                  | 57,600        | 1,979,163             | 1,935,360         | 0.06%    |
| CHINA UNICOM                    | 190,000       | 1,836,173             | 1,692,900         | 0.05%    |
| CINTAS CORP                     | 42,300        | 1,769,893             | 1,681,848         | 0.05%    |
| MERCK + CO INC                  | 41,700        | 1,385,339             | 1,519,131         | 0.05%    |
| LEHMAN BROTHERS HOLDINGS INC    | 22,800        | 1,495,342             | 1,485,420         | 0.05%    |
| KOHL'S CORP                     | 23,700        | 1,254,664             | 1,401,144         | 0.04%    |
| EXELON CORP                     | 23,000        | 1,275,813             | 1,307,090         | 0.04%    |
| DANAHER CORP                    | 19,700        | 1,239,944             | 1,267,104         | 0.04%    |
| UNION PAC CORP                  | 13,400        | 1,217,110             | 1,245,664         | 0.04%    |
| PROGRESSIVE CORP OHIO           | 48,300        | 1,294,465             | 1,241,793         | 0.04%    |
| LOEWS CORP                      | 33,200        | 1,119,360             | 1,176,940         | 0.04%    |
| FIFTH THIRD BANCORP             | 31,400        | 1,193,486             | 1,160,230         | 0.04%    |
| PRUDENTIAL FINANCIAL INC        | 14,100        | 1,060,664             | 1,095,570         | 0.03%    |
| BELLSOUTH CORP                  | 28,000        | 952,032               | 1,013,600         | 0.03%    |
| MEDCO HEALTH SOLUTIONS INC      | 17,300        | 917,945               | 990,944           | 0.03%    |
| CARDINAL HEALTH INC             | 15,200        | 1,011,024             | 977,816           | 0.03%    |
| E TRADE FINANCIAL CORP          | 42,400        | 975,017               | 967,568           | 0.03%    |
| HARTFORD FINANCIAL SERVICES GRP | 11,000        | 954,207               | 930,600           | 0.03%    |
| COLGATE PALMOLIVE CO            | 15,500        | 937,567               | 928,450           | 0.03%    |
| NATIONAL CITY CORP              | 25,600        | 944,895               | 926,464           | 0.03%    |
| MOODY'S CORP                    | 17,000        | 899,619               | 925,820           | 0.03%    |
| AON CORP                        | 26,500        | 940,614               | 922,730           | 0.03%    |
| BURLINGTON NORTHERN SANTA FE    | 11,400        | 855,476               | 903,450           | 0.03%    |
| BAKER HUGHES INC                | 10,600        | 891,720               | 867,610           | 0.03%    |
| MARSH + MCLENNAN COS INC        | 32,200        | 899,279               | 865,858           | 0.03%    |
| FIRST DATA CORP                 | 19,100        | 877,822               | 860,264           | 0.03%    |
| FIRST ENERGY CORP               | 15,800        | 823,935               | 856,518           | 0.03%    |
| GENERAL DYNAMICS CORP           | 13,000        | 822,168               | 850,980           | 0.03%    |
| STATE STREET CORPORATION        | 14,600        | 894,534               | 848,114           | 0.03%    |
| NORFOLK SOUTHERN CORP           | 15,900        | 822,375               | 846,198           | 0.03%    |
| OFFICE DEPOT INC                | 20,700        | 839,436               | 786,600           | 0.02%    |
| JOHNSON CTLS INC                | 9,500         | 782,504               | 781,090           | 0.02%    |
| SYNOVUS FINANCIAL CORP          | 29,000        | 759,091               | 776,620           | 0.02%    |
| VALERO ENERGY CORP              | 11,600        | 707,734               | 771,632           | 0.02%    |
| EDISON INTERNATIONAL            | 18,600        | 714,888               | 725,400           | 0.02%    |
| GENWORTH FINANCIAL INC          | 20,800        | 688,101               | 724,672           | 0.02%    |
| ARCHSTONE SMITH TR              | 13,900        | 673,702               | 707,093           | 0.02%    |

| <u>Security Name</u>             | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|----------------------------------|---------------|-----------------------|-------------------|----------|
| BAXTER INTERNATIONAL INC         | 19,200        | 725,403               | 705,792           | 0.02%    |
| ROBERT HALF INTERNATIONAL INC    | 16,700        | 679,829               | 701,400           | 0.02%    |
| CIGNA CORP                       | 7,100         | 660,405               | 699,421           | 0.02%    |
| METLIFE INC                      | 13,600        | 689,332               | 696,456           | 0.02%    |
| ROCKWELL COLLINS INC             | 12,200        | 659,758               | 681,614           | 0.02%    |
| SOUTHWEST AIRLINES CO            | 41,100        | 644,737               | 672,807           | 0.02%    |
| AMERISOURCEBERGEN CORP           | 16,000        | 696,570               | 670,720           | 0.02%    |
| MCGRAW HILL COS INC              | 13,300        | 683,786               | 668,059           | 0.02%    |
| MCKESSON CORP                    | 13,900        | 676,001               | 657,192           | 0.02%    |
| SCHERING PLOUGH CORP             | 34,200        | 653,536               | 650,826           | 0.02%    |
| KELLOGG CO                       | 13,400        | 629,934               | 648,962           | 0.02%    |
| AMERIPRISE FINANCIAL INC         | 14,500        | 640,583               | 647,715           | 0.02%    |
| SUNTRUST BANKS INC               | 8,400         | 633,737               | 640,584           | 0.02%    |
| KROGER CO                        | 29,200        | 583,662               | 638,312           | 0.02%    |
| NEWMONT MNG CORP                 | 11,800        | 605,898               | 624,574           | 0.02%    |
| ILLINOIS TOOL WKS INC            | 13,100        | 647,038               | 622,250           | 0.02%    |
| TELUS CORP                       | 15,100        | 618,949               | 609,738           | 0.02%    |
| SAFEWAY INC                      | 23,000        | 535,996               | 598,000           | 0.02%    |
| CATERPILLAR INC                  | 8,000         | 572,275               | 595,840           | 0.02%    |
| ST JUDE MED INC                  | 18,300        | 625,140               | 593,286           | 0.02%    |
| HUMANA INC                       | 11,000        | 548,559               | 590,700           | 0.02%    |
| ENTERGY CORP                     | 8,300         | 576,871               | 587,225           | 0.02%    |
| SUN MICROSYSTEMS INC             | 141,400       | 646,645               | 586,810           | 0.02%    |
| AMERICAN TOWER CORP              | 18,600        | 571,048               | 578,832           | 0.02%    |
| JABIL CIRCUIT INC                | 22,600        | 740,051               | 578,560           | 0.02%    |
| COUNTRYWIDE FINANCIAL CORP       | 15,100        | 581,910               | 575,008           | 0.02%    |
| BB-T CORP                        | 13,800        | 572,584               | 573,942           | 0.02%    |
| PUBLIC SERVICE ENTERPRISE GROUP  | 8,600         | 539,956               | 568,632           | 0.02%    |
| ANHEUSER BUSCH COS INC           | 12,400        | 564,809               | 565,316           | 0.02%    |
| CROWN CASTLE INTERNATIONAL CORP  | 16,200        | 514,672               | 559,548           | 0.02%    |
| GENERAL MILLS INC                | 10,800        | 558,561               | 557,928           | 0.02%    |
| GENUINE PARTS CO                 | 13,300        | 573,135               | 554,078           | 0.02%    |
| BJ SERVICES CO                   | 14,600        | 510,991               | 543,996           | 0.02%    |
| SCHWAB CHARLES CORP              | 33,100        | 553,117               | 528,938           | 0.02%    |
| ANADARKO PETE CORP               | 11,000        | 537,538               | 524,590           | 0.02%    |
| DUKE ENERGY HOLDING CORP         | 17,800        | 504,084               | 522,786           | 0.02%    |
| EQUITY RESIDENTIAL               | 11,600        | 511,204               | 518,868           | 0.02%    |
| BROWN FORMAN CORP                | 7,200         | 542,013               | 514,440           | 0.02%    |
| INTERNATIONAL GAME TECHNOLOGY    | 13,400        | 491,256               | 508,396           | 0.02%    |
| EOG RESOURCES INC                | 7,200         | 452,761               | 499,248           | 0.02%    |
| MEDIMMUNE INC                    | 18,300        | 558,531               | 495,930           | 0.02%    |
| HOSPIRA INC                      | 11,300        | 489,516               | 485,222           | 0.02%    |
| ITT CORP                         | 9,800         | 508,939               | 485,100           | 0.02%    |
| FIRST HORIZON NATIONAL CORP      | 12,000        | 483,480               | 482,400           | 0.02%    |
| WHIRLPOOL CORP                   | 5,800         | 512,287               | 479,370           | 0.02%    |
| CUMMINS INC                      | 3,900         | 418,922               | 476,775           | 0.02%    |
| MARATHON OIL CORP                | 5,700         | 425,641               | 474,810           | 0.02%    |
| NUCOR CORP                       | 8,600         | 452,789               | 466,550           | 0.01%    |
| BROADCOM CORP                    | 15,500        | 509,325               | 465,775           | 0.01%    |
| NEWELL RUBBERMAID INC            | 17,900        | 468,181               | 462,357           | 0.01%    |
| AGILENT TECHNOLOGIES INC         | 14,500        | 495,511               | 457,620           | 0.01%    |
| PNC FINANCIAL SERVICES GROUP INC | 6,500         | 444,421               | 456,105           | 0.01%    |
| OMNICOM GROUP                    | 5,100         | 476,775               | 454,359           | 0.01%    |
| BOSTON SCIENTIFIC CORP           | 26,900        | 535,041               | 452,996           | 0.01%    |
| BOSTON PPTYS INC                 | 5,000         | 430,163               | 452,000           | 0.01%    |
| ARCHER DANIELS MIDLAND CO        | 10,900        | 443,882               | 449,952           | 0.01%    |
| KINDER MORGAN INC                | 4,500         | 379,485               | 449,505           | 0.01%    |
| NORTHERN TRUST CORP              | 8,100         | 448,945               | 447,930           | 0.01%    |
| LINCOLN NATIONAL CORP IN         | 7,900         | 440,067               | 445,876           | 0.01%    |
| AMAZON COM INC                   | 11,500        | 399,518               | 444,820           | 0.01%    |
| OCCIDENTAL PETE CORP             | 4,300         | 414,462               | 440,965           | 0.01%    |
| DOVER CORP                       | 8,900         | 429,687               | 439,927           | 0.01%    |
| DOW CHEM CO                      | 11,200        | 443,211               | 437,136           | 0.01%    |

| <u>Security Name</u>          | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|-------------------------------|---------------|-----------------------|-------------------|----------|
| MURPHY OIL CORP               | 7,700         | 393,980               | 430,122           | 0.01%    |
| PRINCIPAL FINANCIAL GROUP     | 7,700         | 417,584               | 428,505           | 0.01%    |
| LEGG MASON INC                | 4,300         | 412,351               | 427,936           | 0.01%    |
| M + T BK CORP                 | 3,600         | 413,741               | 424,512           | 0.01%    |
| TEKTRONIX INC                 | 14,300        | 442,050               | 420,706           | 0.01%    |
| HARMAN INTERNATIONAL INDS INC | 4,900         | 409,156               | 418,313           | 0.01%    |
| THERMO ELECTRON CORP          | 11,500        | 418,128               | 416,760           | 0.01%    |
| CLOROX CO                     | 6,800         | 425,935               | 414,596           | 0.01%    |
| GRAINGER W W INC              | 5,500         | 395,390               | 413,765           | 0.01%    |
| TJX COS INC                   | 18,000        | 424,867               | 411,480           | 0.01%    |
| INTUIT                        | 6,800         | 369,260               | 410,652           | 0.01%    |
| FEDEX CORP                    | 3,400         | 368,561               | 397,324           | 0.01%    |
| TXU CORP                      | 6,600         | 375,305               | 394,614           | 0.01%    |
| ECOLAB INC                    | 9,700         | 372,687               | 393,626           | 0.01%    |
| REYNOLDS AMERN INC            | 3,400         | 377,974               | 392,020           | 0.01%    |
| KERR MCGEE CORP               | 5,600         | 290,448               | 388,360           | 0.01%    |
| UNIVISION COMMUNICATIONS INC  | 11,500        | 407,248               | 385,250           | 0.01%    |
| SAFECO CORP                   | 6,800         | 374,184               | 383,180           | 0.01%    |
| ZIONS BANCORP                 | 4,900         | 392,455               | 381,906           | 0.01%    |
| GENERAL MOTORS CORP           | 12,800        | 341,420               | 381,312           | 0.01%    |
| LOCKHEED MARTIN CORP          | 5,300         | 385,776               | 380,222           | 0.01%    |
| AES CORP                      | 20,500        | 372,710               | 378,225           | 0.01%    |
| MYLAN LABS INC                | 18,800        | 393,046               | 376,000           | 0.01%    |
| COVENTRY HEALTH CARE INC      | 6,800         | 349,180               | 373,592           | 0.01%    |
| KING PHARMACEUTICALS INC      | 21,700        | 381,473               | 368,900           | 0.01%    |
| PPL CORP                      | 11,300        | 337,867               | 364,990           | 0.01%    |
| PROLOGIS                      | 7,000         | 349,039               | 364,840           | 0.01%    |
| CHUBB CORP                    | 7,300         | 365,266               | 364,270           | 0.01%    |
| SEMPRA ENERGY                 | 7,800         | 349,269               | 354,744           | 0.01%    |
| SUNOCO INC                    | 5,100         | 342,234               | 353,379           | 0.01%    |
| PG-E CORP                     | 8,900         | 350,466               | 349,592           | 0.01%    |
| XILINX INC                    | 15,400        | 381,631               | 348,810           | 0.01%    |
| CENTURYTEL INC                | 9,300         | 328,316               | 345,495           | 0.01%    |
| INTERNATIONAL PAPER CO        | 10,600        | 352,195               | 342,380           | 0.01%    |
| SYMBOL TECHNOLOGIES INC       | 31,400        | 360,323               | 338,806           | 0.01%    |
| CAMPBELL SOUP CO              | 9,100         | 316,905               | 337,701           | 0.01%    |
| WASHINGTON MUTUAL INC         | 7,400         | 337,340               | 337,292           | 0.01%    |
| DOMINION RES INC VA           | 4,500         | 327,577               | 336,555           | 0.01%    |
| MCAFEE INC                    | 13,700        | 320,694               | 332,499           | 0.01%    |
| WASTE MANGEMENT INC           | 9,200         | 331,858               | 330,096           | 0.01%    |
| RAYTHEON CO                   | 7,300         | 328,872               | 325,361           | 0.01%    |
| CITRIX SYS INC                | 8,100         | 305,485               | 325,134           | 0.01%    |
| CSX CORP                      | 4,600         | 304,013               | 324,024           | 0.01%    |
| CIRCUIT CITY STORES INC       | 11,900        | 346,487               | 323,918           | 0.01%    |
| APPLERA CORP APPLIED BIOSYS   | 10,000        | 294,003               | 323,500           | 0.01%    |
| GOODRICH CORP                 | 8,000         | 335,771               | 322,320           | 0.01%    |
| CITIZENS COMMUNICATIONS CO    | 24,000        | 303,576               | 313,200           | 0.01%    |
| DONNELLEY R R + SONS CO       | 9,800         | 313,497               | 313,110           | 0.01%    |
| DARDEN RESTAURANTS INC        | 7,900         | 286,241               | 311,260           | 0.01%    |
| PRICE T ROWE GROUP INC        | 8,200         | 318,878               | 310,042           | 0.01%    |
| BEAR STEARNS COS INC          | 2,200         | 288,362               | 308,176           | 0.01%    |
| CHICAGO MERCANTILE EXCHANGE   | 620           | 271,944               | 304,513           | 0.01%    |
| FOREST LABS INC               | 7,800         | 290,152               | 301,782           | 0.01%    |
| SANDISK CORP                  | 5,900         | 325,725               | 300,782           | 0.01%    |
| MONSTER WORLDWIDE INC         | 7,000         | 345,604               | 298,620           | 0.01%    |
| CAPITALSOURCE INC             | 12,700        | 293,522               | 297,942           | 0.01%    |
| PHELPS DODGE CORP             | 3,600         | 299,627               | 295,776           | 0.01%    |
| NORTHROP GRUMMAN CORP         | 4,600         | 297,113               | 294,676           | 0.01%    |
| TIFFANY + CO                  | 8,900         | 289,342               | 293,878           | 0.01%    |
| ACE LTD                       | 5,800         | 298,690               | 293,422           | 0.01%    |
| LAMAR ADVERTISING CO          | 5,400         | 296,291               | 290,844           | 0.01%    |
| TD AMERITRADE HOLDING CORP    | 19,400        | 329,164               | 287,314           | 0.01%    |
| MILLIPORE CORP                | 4,500         | 313,674               | 283,455           | 0.01%    |

| <u>Security Name</u>          | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|-------------------------------|---------------|-----------------------|-------------------|----------|
| CIT GROUP INC                 | 5,300         | 269,520               | 277,137           | 0.01%    |
| BMC SOFTWARE INC              | 11,500        | 234,702               | 274,850           | 0.01%    |
| SIMON PTY GROUP INC           | 3,300         | 263,908               | 273,702           | 0.01%    |
| NVIDIA CORP                   | 12,700        | 293,583               | 270,383           | 0.01%    |
| LUCENT TECHNOLOGIES INC       | 111,400       | 285,731               | 269,588           | 0.01%    |
| AVERY DENNISON CORP           | 4,600         | 270,792               | 267,076           | 0.01%    |
| BHP BILLITON LTD              | 6,200         | 268,219               | 267,034           | 0.01%    |
| SHERWIN WILLIAMS CO           | 5,600         | 265,838               | 265,888           | 0.01%    |
| HESS CORP                     | 5,000         | 245,188               | 264,250           | 0.01%    |
| ELECTRONIC DATA SYS CORP      | 10,900        | 266,317               | 262,254           | 0.01%    |
| TORCHMARK INC                 | 4,300         | 250,718               | 261,096           | 0.01%    |
| NABORS INDUSTRIES LTD         | 7,700         | 271,486               | 260,183           | 0.01%    |
| GRANT PRIDECO INC             | 5,800         | 264,961               | 259,550           | 0.01%    |
| MICRON TECHNOLOGY INC         | 17,100        | 275,597               | 257,526           | 0.01%    |
| RYDER SYS INC                 | 4,400         | 233,878               | 257,092           | 0.01%    |
| FEDERATED INVS INC PA         | 8,100         | 259,339               | 255,150           | 0.01%    |
| AMERICAN STD COS INC          | 5,800         | 247,751               | 250,966           | 0.01%    |
| ROGERS COMMUNICATIONS INC     | 6,200         | 253,162               | 250,480           | 0.01%    |
| COMERICA INC                  | 4,800         | 262,756               | 249,552           | 0.01%    |
| FISERV INC                    | 5,500         | 235,708               | 249,480           | 0.01%    |
| TOTAL SA                      | 3,800         | 246,247               | 248,976           | 0.01%    |
| KIMBERLY CLARK CORP           | 4,000         | 242,164               | 246,800           | 0.01%    |
| LINEAR TECHNOLOGY CORP        | 7,300         | 244,429               | 244,477           | 0.01%    |
| SABRE HOLDINGS CORP           | 11,100        | 236,254               | 244,200           | 0.01%    |
| NATIONAL SEMICONDUCTOR CORP   | 10,000        | 252,469               | 238,500           | 0.01%    |
| FEDERATED DEPT STORES INC     | 6,500         | 230,650               | 237,900           | 0.01%    |
| FMC TECHNOLOGIES INC          | 3,500         | 229,443               | 236,110           | 0.01%    |
| HARRAHS ENTERTAINMENT INC     | 3,300         | 248,395               | 234,894           | 0.01%    |
| XTO ENERGY INC                | 5,300         | 213,537               | 234,631           | 0.01%    |
| PINNACLE WEST CAP CORP        | 5,800         | 226,083               | 231,478           | 0.01%    |
| COMPUTER SCIENCES CORP        | 4,700         | 259,207               | 227,668           | 0.01%    |
| CBOT HOLDINGS INC             | 1,900         | 197,430               | 227,221           | 0.01%    |
| LENNAR CORP                   | 5,100         | 244,276               | 226,287           | 0.01%    |
| EATON CORP                    | 3,000         | 216,870               | 226,200           | 0.01%    |
| MARVELL TECHNOLOGY GROUP LTD  | 5,100         | 243,414               | 226,083           | 0.01%    |
| DOW JONES + CO INC            | 6,400         | 220,866               | 224,064           | 0.01%    |
| MEREDITH CORP                 | 4,500         | 224,898               | 222,930           | 0.01%    |
| NORDSTROM INC                 | 6,100         | 216,295               | 222,650           | 0.01%    |
| MOLEX INC                     | 6,600         | 230,308               | 221,562           | 0.01%    |
| AUTONATION INC                | 10,300        | 221,962               | 220,832           | 0.01%    |
| AVON PRODS INC                | 7,100         | 224,131               | 220,100           | 0.01%    |
| REGIONS FINANCIAL CORP        | 6,600         | 223,470               | 218,592           | 0.01%    |
| EQUIFAX INC                   | 6,300         | 223,771               | 216,342           | 0.01%    |
| MANOR CARE INC                | 4,600         | 214,093               | 215,832           | 0.01%    |
| GENZYME CORP                  | 3,500         | 208,002               | 213,675           | 0.01%    |
| ROSS STORES INC               | 7,600         | 210,176               | 213,180           | 0.01%    |
| CONSOL ENERGY INC             | 4,500         | 201,387               | 210,240           | 0.01%    |
| REPUBLIC SERVICES INC         | 5,200         | 211,305               | 209,768           | 0.01%    |
| BIAGEN IDEC INC               | 4,500         | 211,455               | 208,485           | 0.01%    |
| MGIC INVT CORP                | 3,200         | 209,293               | 208,000           | 0.01%    |
| ALCOA INC                     | 6,400         | 200,253               | 207,104           | 0.01%    |
| PITNEY BOWES INC              | 5,000         | 207,871               | 206,500           | 0.01%    |
| YUM BRANDS INC                | 4,100         | 208,150               | 206,107           | 0.01%    |
| LABORATORY CORP AMER HOLDINGS | 3,300         | 197,953               | 205,359           | 0.01%    |
| RED HAT INC                   | 8,700         | 211,102               | 203,580           | 0.01%    |
| ECHOSTAR COMMUNICATIONS CORP  | 6,600         | 198,601               | 203,346           | 0.01%    |
| PENNEY J C INC                | 3,000         | 179,644               | 202,530           | 0.01%    |
| BARR PHARMACEUTICALS INC      | 4,200         | 218,983               | 200,298           | 0.01%    |
| WENDYS INTERNATIONAL INC      | 3,400         | 200,439               | 198,186           | 0.01%    |
| ALLEGHENY TECHNOLOGIES INC    | 2,800         | 175,893               | 193,872           | 0.01%    |
| WEYERHAEUSER CO               | 3,100         | 197,975               | 192,975           | 0.01%    |
| PEPSI BOTTLING GROUP INC      | 6,000         | 188,473               | 192,900           | 0.01%    |
| MARRIOTT INTERNATIONAL INC    | 5,000         | 180,444               | 190,600           | 0.01%    |

| <u>Security Name</u>             | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|----------------------------------|---------------|-----------------------|-------------------|----------|
| SHIRE PLC                        | 4,300         | 186,196               | 190,189           | 0.01%    |
| XL CAPITAL LTD                   | 3,100         | 194,289               | 190,030           | 0.01%    |
| HEINZ H J CO                     | 4,600         | 193,831               | 189,612           | 0.01%    |
| SOUTHERN CO                      | 5,800         | 183,791               | 185,890           | 0.01%    |
| LIBERTY MEDIA HOLDING CORP       | 2,900         | 180,894               | 183,074           | 0.01%    |
| CONSOLIDATED EDISON INC          | 4,100         | 179,472               | 182,204           | 0.01%    |
| COOPER INDUSTRIES LTD            | 1,900         | 164,961               | 176,548           | 0.01%    |
| XCEL ENERGY INC                  | 9,200         | 170,574               | 176,456           | 0.01%    |
| COCA COLA ENTERPRISES INC        | 8,600         | 168,629               | 175,182           | 0.01%    |
| STARWOOD HOTELS + RESORTS INC    | 2,900         | 177,590               | 174,986           | 0.01%    |
| PALL CORP                        | 6,100         | 182,024               | 170,800           | 0.01%    |
| PARKER HANNIFIN CORP             | 2,200         | 167,599               | 170,720           | 0.01%    |
| CONVERGYS CORP                   | 8,700         | 160,071               | 169,650           | 0.01%    |
| KEYCORP                          | 4,700         | 167,525               | 167,696           | 0.01%    |
| FLUOR CORP                       | 1,800         | 159,891               | 167,274           | 0.01%    |
| AMSOUTH BANCORPORATION           | 6,200         | 167,191               | 163,990           | 0.01%    |
| FLEXTRONICS INTERNATIONAL LTD    | 15,400        | 174,453               | 163,548           | 0.01%    |
| GOLDEN WEST FINANCIAL CORP       | 2,200         | 159,528               | 163,240           | 0.01%    |
| UNUM PROVIDENT CORP              | 9,000         | 159,339               | 163,170           | 0.01%    |
| AFFILIATED COMPUTER SERVICES INC | 3,100         | 153,274               | 159,991           | 0.01%    |
| GANNETT INC                      | 2,800         | 153,236               | 156,604           | 0.00%    |
| NAVTEQ CORP                      | 3,500         | 147,239               | 156,380           | 0.00%    |
| KIMCO RLTY CORP                  | 4,100         | 147,992               | 149,609           | 0.00%    |
| FREEPORT MCMORAN COPPER + GOLD   | 2,700         | 151,227               | 149,607           | 0.00%    |
| SNAP ON INC                      | 3,700         | 150,677               | 149,554           | 0.00%    |
| QLOGIC CORP                      | 8,600         | 150,912               | 148,264           | 0.00%    |
| CONSTELLATION ENERGY GROUP INC   | 2,700         | 139,872               | 147,204           | 0.00%    |
| WEATHERFORD INTERNATIONAL LTD    | 2,900         | 146,166               | 143,898           | 0.00%    |
| IMS HEALTH INC                   | 5,300         | 143,390               | 142,305           | 0.00%    |
| TECO ENERGY INC                  | 9,400         | 138,395               | 140,436           | 0.00%    |
| VULCAN MATLS CO                  | 1,800         | 139,994               | 140,400           | 0.00%    |
| NRG ENERGY INC                   | 2,900         | 125,527               | 139,722           | 0.00%    |
| SYMANTEC CORP                    | 8,900         | 138,361               | 138,306           | 0.00%    |
| MCCORMICK + CO INC               | 4,100         | 140,631               | 137,555           | 0.00%    |
| WATSON PHARMACEUTICALS INC       | 5,800         | 147,519               | 135,024           | 0.00%    |
| AGL RES INC                      | 3,500         | 126,128               | 133,420           | 0.00%    |
| ADVANCED MICRO DEVICES INC       | 5,400         | 165,844               | 131,868           | 0.00%    |
| D R HORTON INC                   | 5,500         | 145,538               | 131,010           | 0.00%    |
| V F CORP                         | 1,900         | 118,361               | 129,048           | 0.00%    |
| COMPASS BANCSHARES INC           | 2,300         | 127,402               | 127,880           | 0.00%    |
| ALCAN INC                        | 2,700         | 138,107               | 126,738           | 0.00%    |
| TELLABS INC                      | 9,500         | 134,795               | 126,445           | 0.00%    |
| CLEAR CHANNEL COMMUNICATIONS     | 3,900         | 120,450               | 120,705           | 0.00%    |
| TEMPLE INLAND INC                | 2,800         | 119,198               | 120,036           | 0.00%    |
| ALCON INC                        | 1,200         | 127,803               | 118,260           | 0.00%    |
| AVAYA INC                        | 10,300        | 117,948               | 117,626           | 0.00%    |
| TRIBUNE CO                       | 3,600         | 107,629               | 116,748           | 0.00%    |
| HILTON HOTELS CORP               | 4,100         | 112,493               | 115,948           | 0.00%    |
| AUTOZONE INC                     | 1,300         | 116,155               | 114,660           | 0.00%    |
| FREESCALE SEMICONDUCTOR INC      | 3,900         | 120,551               | 114,660           | 0.00%    |
| PANERA BREAD CO                  | 1,700         | 109,763               | 114,308           | 0.00%    |
| ALLEGHENY ENERGY INC             | 3,000         | 107,751               | 111,210           | 0.00%    |
| DYNEGY INC                       | 20,200        | 101,323               | 110,494           | 0.00%    |
| HCA INC                          | 2,500         | 109,510               | 107,875           | 0.00%    |
| BIG LOTS INC                     | 6,300         | 100,020               | 107,604           | 0.00%    |
| ELECTRONIC ARTS INC              | 2,500         | 106,076               | 107,600           | 0.00%    |
| AXIS CAPITAL HOLDINGS LTD        | 3,700         | 98,689                | 105,857           | 0.00%    |
| MARSHALL + ILSLEY CORP           | 2,300         | 104,112               | 105,202           | 0.00%    |
| AFFILIATED MANAGERS GROUP INC    | 1,200         | 108,653               | 104,268           | 0.00%    |
| ALLSTATE CORP                    | 1,900         | 103,852               | 103,987           | 0.00%    |
| POTASH CORP SASK INC             | 1,200         | 109,006               | 103,164           | 0.00%    |
| AMERICAN ELECTRIC POWER INC      | 3,000         | 101,040               | 102,750           | 0.00%    |
| NCR CORP                         | 2,800         | 107,034               | 102,592           | 0.00%    |

| <u>Security Name</u>                | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|-------------------------------------|---------------|-----------------------|-------------------|----------|
| PATTERSON COS INC                   | 2,900         | 100,190               | 101,297           | 0.00%    |
| SCRIPPS E W CO OH                   | 2,300         | 106,979               | 99,222            | 0.00%    |
| CDW CORP                            | 1,800         | 99,766                | 98,370            | 0.00%    |
| AMEREN CORP                         | 1,900         | 92,882                | 95,950            | 0.00%    |
| FISHER SCIENTIFIC INTERNATIONAL INC | 1,300         | 95,879                | 94,965            | 0.00%    |
| SIGMA ALDRICH                       | 1,300         | 89,670                | 94,432            | 0.00%    |
| KLA TENCOR CORP                     | 2,200         | 89,398                | 91,454            | 0.00%    |
| PUBLIC STORAGE INC                  | 1,200         | 87,218                | 91,080            | 0.00%    |
| WYNN RESORTS LTD                    | 1,200         | 84,355                | 87,960            | 0.00%    |
| MATTEL INC                          | 5,300         | 88,662                | 87,503            | 0.00%    |
| HARLEY DAVIDSON INC                 | 1,500         | 74,953                | 82,335            | 0.00%    |
| ALLIED WASTE INDUSTRIES INC         | 7,200         | 82,730                | 81,792            | 0.00%    |
| NETWORK APPLIANCE INC               | 2,300         | 78,754                | 81,190            | 0.00%    |
| PRAXAIR INC                         | 1,500         | 78,825                | 81,000            | 0.00%    |
| BRUNSWICK CORP                      | 2,400         | 85,957                | 79,800            | 0.00%    |
| ROCKWELL AUTOMATION INC             | 1,100         | 72,498                | 79,211            | 0.00%    |
| CEPHALON INC                        | 1,300         | 76,326                | 78,130            | 0.00%    |
| WASHINGTON POST CO                  | 100           | 80,015                | 78,001            | 0.00%    |
| CHESAPEAKE ENERGY CORP              | 2,500         | 74,650                | 75,625            | 0.00%    |
| COMMERCE BANCORP INC N J            | 2,100         | 81,310                | 74,907            | 0.00%    |
| NICOR INC                           | 1,800         | 73,158                | 74,700            | 0.00%    |
| MOLSON COORS BREWING CO             | 1,100         | 72,194                | 74,668            | 0.00%    |
| COMMUNITY HEALTH SYSTEMS INC        | 2,000         | 74,858                | 73,500            | 0.00%    |
| QUEST DIAGNOSTICS INC               | 1,200         | 68,352                | 71,904            | 0.00%    |
| WILLIS GROUP HOLDINGS LTD           | 2,200         | 75,374                | 70,620            | 0.00%    |
| SUPERVALU INC                       | 2,211         | 65,650                | 67,884            | 0.00%    |
| COMVERSE TECHNOLOGY INC             | 3,400         | 76,939                | 67,218            | 0.00%    |
| FPL GROUP INC                       | 1,600         | 62,559                | 66,208            | 0.00%    |
| VERISIGN INC                        | 2,800         | 62,711                | 64,876            | 0.00%    |
| JONES APPAREL GROUP INC             | 2,000         | 64,398                | 63,580            | 0.00%    |
| NISOURCE INC                        | 2,900         | 63,194                | 63,336            | 0.00%    |
| SEALED AIR CORP                     | 1,200         | 61,269                | 62,496            | 0.00%    |
| APOLLO GROUP INC                    | 1,200         | 62,252                | 62,004            | 0.00%    |
| STANDARD PAC CORP                   | 2,400         | 72,506                | 61,680            | 0.00%    |
| BECTON DICKINSON + CO               | 1,000         | 59,889                | 61,130            | 0.00%    |
| OFFICEMAX INC                       | 1,500         | 62,606                | 61,125            | 0.00%    |
| CINCINNATI FINANCIAL CORP           | 1,300         | 59,036                | 61,113            | 0.00%    |
| PERKINELMER INC                     | 2,900         | 58,749                | 60,610            | 0.00%    |
| L 3 COMMUNICATIONS HOLDING CORP     | 800           | 62,148                | 60,336            | 0.00%    |
| EQUITY OFFICE PPTYS TR              | 1,600         | 54,016                | 58,416            | 0.00%    |
| WHOLE FOODS MARKET INC              | 900           | 58,080                | 58,176            | 0.00%    |
| CA INC                              | 2,800         | 60,212                | 57,540            | 0.00%    |
| BOWATER INC                         | 2,500         | 59,860                | 56,875            | 0.00%    |
| DOLLAR GEN CORP                     | 3,900         | 62,935                | 54,522            | 0.00%    |
| CNET NETWORKS INC                   | 6,700         | 60,198                | 53,466            | 0.00%    |
| FAMILY DOLLAR STORES INC            | 2,100         | 51,693                | 51,303            | 0.00%    |
| SARA LEE CORP                       | 3,100         | 49,887                | 49,662            | 0.00%    |
| POTLATCH CORP                       | 1,300         | 48,796                | 49,075            | 0.00%    |
| AMERICAN POWER CONVERSION CORP      | 2,500         | 48,810                | 48,725            | 0.00%    |
| HEALTH MANGEMENT ASSOC              | 2,400         | 49,027                | 47,304            | 0.00%    |
| STANLEY WORKS                       | 1,000         | 48,050                | 47,220            | 0.00%    |
| APARTMENT INVT + MANAGEMENT CO      | 900           | 39,315                | 39,105            | 0.00%    |
| TYSON FOODS INC                     | 2,600         | 41,808                | 38,636            | 0.00%    |
| JANUS CAP GROUP INC                 | 2,100         | 37,334                | 37,590            | 0.00%    |
| INVESTORS FINANCIAL SERVICES CORP   | 800           | 36,111                | 35,920            | 0.00%    |
| MBIA INC                            | 600           | 34,060                | 35,130            | 0.00%    |
| UNITED STS STL CORP                 | 500           | 34,770                | 35,060            | 0.00%    |
| SEPRACOR INC                        | 600           | 30,675                | 34,284            | 0.00%    |
| EMBARQ CORP                         | 800           | 32,600                | 32,792            | 0.00%    |
| NOBLE CORPORATION                   | 400           | 27,137                | 29,768            | 0.00%    |
| VORNADO RLTY TR                     | 300           | 27,457                | 29,265            | 0.00%    |
| NOVELI US SYS INC                   | 1,100         | 25,375                | 27,170            | 0.00%    |
| CONAGRA INC                         | 1,200         | 26,424                | 26,532            | 0.00%    |

| <u>Security Name</u>                               | <u>Shares</u>     | <u>Carrying Value</u> | <u>Fair Value</u>    | <u>%</u>       |
|----------------------------------------------------|-------------------|-----------------------|----------------------|----------------|
| ALTERA CORP                                        | 1,500             | 28,543                | 26,325               | 0.00%          |
| LIMITED BRANDS INC                                 | 1,000             | 25,408                | 25,590               | 0.00%          |
| TERADYNE INC                                       | 1,700             | 25,467                | 23,681               | 0.00%          |
| ADC TELECOMMUNICATIONS INC                         | 1,300             | 29,125                | 21,918               | 0.00%          |
| MCCLATCHY CO                                       | 461               | 20,431                | 18,480               | 0.00%          |
| XEROX CORP                                         | 1,200             | 16,132                | 16,692               | 0.00%          |
| <b>DOMESTIC EQUITY SECURITIES</b>                  | <b>32,204,392</b> | <b>1,136,608,043</b>  | <b>1,302,172,583</b> | <b>41.30%</b>  |
| STATE STREET STIF                                  | 4,211,051         | 4,211,051             | 4,211,051            | 0.13%          |
| STATE STREET STIF                                  | 287,662           | 287,662               | 287,662              | 0.01%          |
| STATE STREET STIF                                  | 521,743           | 521,743               | 521,743              | 0.02%          |
| T ROWE PRICE RES INV FUND                          | 400,622           | 400,622               | 400,622              | 0.01%          |
| <b>CASH EQUIVALENTS</b>                            | <b>5,421,077</b>  | <b>5,421,077</b>      | <b>5,421,077</b>     | <b>0.17%</b>   |
| <b>TOTAL SEPARATE DOMESTIC ACCOUNTS</b>            | <b>37,625,469</b> | <b>1,142,029,120</b>  | <b>1,307,593,660</b> | <b>41.48%</b>  |
| GOLDMAN SACHS                                      | 9,330,103         | 125,956,387           | 124,463,571          | 3.95%          |
| <b>GOLDMAN SACHS LARGE CAP ENHANCED INDEX</b>      | <b>9,330,103</b>  | <b>125,956,387</b>    | <b>124,463,571</b>   | <b>3.95%</b>   |
| WESTERN ASSET MANAGEMENT CO (WAMCO)                | 8,976,856         | 126,937,301           | 125,424,632          | 3.98%          |
| <b>WAMCO LARGE CAP ENHANCED INDEX PLUS</b>         | <b>8,976,856</b>  | <b>126,937,301</b>    | <b>125,424,632</b>   | <b>3.98%</b>   |
| BGI S&P 500 EQUITY INDEX FUND A                    | 3,340,346         | 995,420,724           | 1,178,260,317        | 37.37%         |
| BGI CASH                                           | 1                 | 1                     | 1                    | 0.00%          |
| <b>BGI S&amp;P 500 PASSIVE EQUITY INDEX FUND</b>   | <b>3,340,347</b>  | <b>995,420,725</b>    | <b>1,178,260,318</b> | <b>37.37%</b>  |
| DIMENSIONAL FUND ADVISORS INC                      | 199,064           | 133,993,753           | 213,902,449          | 6.78%          |
| <b>DFA SMALL CAP SUBTRUST</b>                      | <b>199,064</b>    | <b>133,993,753</b>    | <b>213,902,449</b>   | <b>6.78%</b>   |
| BGI S&P 400 MIDCAP EQUITY INDEX FUND               | 9,982,317         | 165,000,000           | 191,367,605          | 6.07%          |
| <b>BGI S&amp;P 400 MIDCAP PASSIVE EQUITY INDEX</b> | <b>9,982,317</b>  | <b>165,000,000</b>    | <b>191,367,605</b>   | <b>6.07%</b>   |
| STATE STREET SPIFF                                 | 69,420            | 11,533,284            | 11,691,519           | 0.37%          |
| <b>EQUITY FUTURES</b>                              | <b>69,420</b>     | <b>11,533,284</b>     | <b>11,691,519</b>    | <b>0.37%</b>   |
| <b>Total MDEP</b>                                  | <b>69,523,576</b> | <b>2,700,870,570</b>  | <b>3,152,703,754</b> | <b>100.00%</b> |

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana International Equity Pool, as of June 30, 2006, and 2005, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana International Equity Pool, as of June 30, 2006, and 2005, and its changes in net asset value and investment income and distribution for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA INTERNATIONAL EQUITY POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2006 AND 2005

|                                                                                                                          | <u>2006</u>             | <u>2005</u>             |
|--------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| <u>Assets</u>                                                                                                            |                         |                         |
| Cash at fair value (carrying value of \$3,638,650 in 2006 and \$1,996,217 in 2005) (Notes 2 and 4)                       | \$ 3,654,878            | \$ 1,968,498            |
| Security lending cash collateral (Notes 3 and 4)                                                                         | 31,330,825              | 34,537,173              |
| Broker receivable for securities sold but not settled (Note 2)                                                           | 1,337,238               | 735,494                 |
| Dividend and interest receivable                                                                                         | 592,169                 | 1,419,646               |
| Investments managed at fair value (carrying value of \$913,072,853 in 2006 and \$840,131,984 in 2005) (Notes 2, 4 and 7) | <u>1,241,048,341</u>    | <u>993,518,620</u>      |
| Total assets                                                                                                             | \$ <u>1,277,963,451</u> | \$ <u>1,032,179,431</u> |
| <u>Liabilities</u>                                                                                                       |                         |                         |
| Income due participants                                                                                                  | \$ 997,800              | \$ 1,459,877            |
| Broker payable for securities purchased but not settled (Note 2)                                                         | 1,768,392               | 837,394                 |
| Security lending obligations (Note 3)                                                                                    | 31,330,825              | 34,537,173              |
| Security lending expense payable                                                                                         | 116,732                 | 113,089                 |
| Unrealized foreign exchange market gain (loss)                                                                           | 4,965                   | (1,670,430)             |
| Administrative fee payable                                                                                               | <u>295,474</u>          | <u>445,565</u>          |
| Total liabilities                                                                                                        | <u>34,514,188</u>       | <u>35,722,668</u>       |
| Net asset value                                                                                                          | \$ <u>1,243,449,263</u> | \$ <u>996,456,763</u>   |
| Units Outstanding (Note 2)                                                                                               | 8,194,363               | 8,192,033               |
| Unit Value (Note 2)                                                                                                      | \$ 151.74               | \$ 121.64               |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                                   |                         |                       |
|---------------------------------------------------|-------------------------|-----------------------|
| Net asset value, beginning of year                | \$ 996,456,763          | \$ 857,914,811        |
| Value of units purchased by participants (Note 2) | 845,000                 | 25,000,000            |
| Value of units sold by participants               | (355,150)               | 0                     |
| Changes in current value of investments managed   | <u>246,502,650</u>      | <u>113,541,952</u>    |
| Net asset value, end of year                      | \$ <u>1,243,449,263</u> | \$ <u>996,456,763</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                            |                   |                     |
|--------------------------------------------|-------------------|---------------------|
| Investment income (Note 2)                 | \$ 11,920,667     | \$ 11,001,773       |
| Security lending income                    | 1,371,073         | 1,317,472           |
| Security lending expense                   | (1,278,676)       | (1,106,889)         |
| Administrative expenses (Note 2)           | (2,366,359)       | (2,641,330)         |
| Income due participants, beginning of year | <u>1,459,877</u>  | <u>926,817</u>      |
| Income available for distribution          | 11,106,582        | 9,497,843           |
| Distribution (Note 2)                      | <u>10,108,782</u> | <u>8,037,966</u>    |
| Income due participants, end of year       | \$ <u>997,800</u> | \$ <u>1,459,877</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA INTERNATIONAL EQUITY POOL

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2006 and 2005

**I. HISTORY AND ORGANIZATION**

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Montana International Equity Pool (MTIP) was approved by the Board in June 1996 and created in January 1997 with the nine pension funds as participants. MTIP provides the participants an opportunity to invest in the international equity market via a diversified pool that includes several different investment managers.

There are currently six separate managers investing funds within the MTIP. The date each manager was first funded, the fair value of each cash and equity portfolio as of June 30, 2006, and the percent of the MTIP total is shown in the table below:

| <u>Manager</u>                                                 | <u>Funding Date</u> | <u>Fair Value</u>       | <u>% of Total</u> |
|----------------------------------------------------------------|---------------------|-------------------------|-------------------|
| Schroder Investment Management                                 | January 1997        | \$ 139,585,656          | 11.21%            |
| Barclays Global Investors (BGI) Equity Index Fund Europe       | May 2003            | 768,768,601             | 61.76%            |
| Barclays Global Investors (BGI) Passive Pacific Index Strategy | August 2003         | 65,943,278              | 5.30%             |
| Nomura Asset Management                                        | December 2003       | 146,838,819             | 11.80%            |
| Dimensional Fund Advisors (DFA) International Small Co.        | October 2004        | 93,071,030              | 7.48%             |
| State Street EAFE ISPIFF (MTIP)                                | November 2005       | <u>30,495,835</u>       | <u>2.45%</u>      |
| Total MTIP                                                     |                     | \$ <u>1,244,703,219</u> | <u>100.00%</u>    |

Schroders, Nomura, and the Barclays Pacific Index are authorized to invest these 12 Pacific Basin countries:

**Pacific Basin Countries**

|           |           |             |           |
|-----------|-----------|-------------|-----------|
| Australia | Indonesia | Malaysia    | Singapore |
| China     | Japan     | New Zealand | Taiwan    |
| Hong Kong | Korea     | Philippines | Thailand  |

The Barclays Europe Index Fund may invest in these 16 European countries:

**European Countries**

|         |         |             |                |
|---------|---------|-------------|----------------|
| Austria | France  | Italy       | Spain          |
| Belgium | Germany | Netherlands | Sweden         |
| Denmark | Greece  | Norway      | Switzerland    |
| Finland | Ireland | Portugal    | United Kingdom |

The DFA International Small Company Portfolio invests in the European countries detailed above and the Pacific Basin countries of Australia, Hong Kong, Japan, New Zealand and Singapore.

In December 2005, the Board terminated Pyrford International, the European external manager. The Board transferred 1,252,186 Pyrford International units held by MTIP at a gain of \$39.5 million to the BGI Restructure account. This transaction involved the exchange of over 12 million shares in 46 positions held by Pyrford to the restructure account. Closure of the BGI Restructure account to the BGI MSCI Europe Index Fund resulted in additional gains of \$1.5 million.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Investments

MTIP investments are purchased in accordance with the statutorily mandated “Prudent Expert Principle”. The MTIP portfolios for fiscal years 2006 and 2005 includes equity investments in six funds that invest in securities of foreign-based corporations listed on legal and recognized foreign exchanges as well as domestic exchanges. Security types may include ordinary common shares, preferred shares, convertible securities, American Depositary Receipts (ADR’s), Global Depositary Receipts (GDR’s), and other global securities, as appropriate.

Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters as well as receive dividends on their holdings. Preferred stock pays a stipulated dividend and has a claim prior to that of common stock upon the earnings of a corporation. Convertible securities are securities carrying the right to exchange, or “convert” the instrument for other securities of the issuer or of another issuer. ADR’s are receipts issued by a US depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. GDR’s are receipts issued by non-US bank depositaries, which represent shares of a foreign stock or bonds.

In November 2005, the Board approved the securitization of MTIP cash by investing in an international equity derivative, the State Street EAFE ( Europe, Asia, Far East) International Stock Performance Index Futures Fund (SPIFF). MTIP cash was previously invested in the domestic SPIFF.

### Broker Receivable/Payable

MTIP security transactions are recorded as of the trade date rather than settlement date. Because of this generally accepted practice, the MTIP portfolio at June 30 may include receivables from brokers for securities sold, but not delivered, and payables to brokers for securities purchased, but not received.

### Valuation and Foreign Currency

Investments are presented in the statement of Net Asset Value at current U.S.dollar value. The MTIP’s fair value is derived from the Net Asset Value per Share, as separately calculated, for three funds - Pyrford International through November 2005, Schroder Investment Management NA, and Nomura Asset Management U.S.A. Inc. Each fund’s Net Asset Value per Share represents the per unit ownership of the fund’s Net Assets. The Net Assets are the excess of the valued securities, cash, receivables and other assets over the fund’s liabilities. Each fund’s Net Assets are reported at current U.S. dollar value after conversion, by the custodial bank, State Street Bank from the foreign currency amounts. The MTIP’s fair value also includes the per share fair value of the BGI MSCI Europe Index Fund, the BGI All Country Pacific Index Strategy Fund, DFA International Small Company Portfolio and the State Street Bank SPIFF account.

State Street Bank, as custodian, is responsible for reporting the foreign currency transactions in both the local and base or functional (U.S. dollar) currency. The three funds’ cash, receivables, fair value of investment securities, other assets and liabilities are translated into U.S. dollars at the Interactive Data Control (IDC) 11:00 a.m. Eastern Standard Time (EST) exchange rate as of June 30. Purchases and sales of investment securities, income and expenses are converted into U.S. dollars using the Reuters noon EST exchange rate on the transaction date.

Currency exposures may be hedged, partially or fully, at the discretion of the manager to preserve the U.S. dollar value of investments made. Currency speculation, such as over-hedging, reverse hedging or other trading activity not specifically aimed at preserving the U.S. dollar value of investments, is not authorized.

Fair values for the funds holding the publicly traded securities are determined by reference to market prices supplied to the Board by the Board’s custodial bank, State Street Bank, their primary pricing service, IDC, Barclays Global Investors and Dimensional Fund Advisors. Equity investments, traded on a national security exchange, are stated at the last reported sales price on valuation day, while equity securities traded in the over-the-counter market are stated at the last quoted bid price.

### Participant Units

The Public Employees’, Municipal Police Officers’, Game Wardens’, Sheriffs’, Judges’, Highway Patrol Officers’, Teachers’, Volunteer Firefighters’ and Firefighters’ Unified retirement funds sold units in the Short Term

Investment Pool at the start up date and were issued units in MTIP at an initial unit value of \$100. Unit values thereafter are calculated weekly and once a month at the close of the last business day of the month, based upon the fair value of the MTIP equity holdings, other assets and liabilities. Based on the investment officers' decision, participants may then buy or sell units on the first business day of each month. All participant buys or sells occur after distribution of accumulated income.

### Investment Income and Distribution

Investment Income represents the monthly income distributions to the MTIP from the investment manager funds. The funds' income distributions include dividends accrued as of the ex-dividend date, interest, tax refunds and securities lending income, and related income currency gains/losses. Income currency gains/losses result from the difference between the amount of dividend, interest and foreign withholding taxes accrued for the fund in US dollars and the amount received or paid in equivalent US dollars.

Realized gains/losses from the sale of securities and related foreign exchange transactions are retained by the MTIP. Realized foreign exchange gains/losses arise from sales and maturities of portfolio securities, sales of foreign currencies, and currency gains/losses realized between the trade and settlement dates.

The fiscal year 2006 administrative expense of \$2,366,359 represents \$1,843,956 in quarterly fees accrued and paid to the external managers per their contracts and \$522,403 in monthly charges accrued and paid to the Board of Investments.

The fiscal year 2005 administrative expense of \$2,641,330 represents \$2,126,429 in quarterly fees accrued and paid to the external managers per their contracts and \$514,901 in monthly charges accrued and paid to the Board of Investments.

As described above, the Board of Investments fee includes costs for the custodial bank contract. Administrative expenses incurred by the Board are charged daily to MTIP based on the Board's expenses applicable to MTIP. The MTIP income available for distribution is distributed at least monthly to the retirement fund participants, net of external manager fees and administrative expenses, on the first business day of the following month.

### 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 105 percent of the fair value of the loaned securities and maintain collateral equal to 105 percent of the fair value of the loaned securities. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar and foreign currency cash, U.S. government securities, sovereign debt of foreign countries, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

The carrying amount and fair value of the underlying securities on loan for MTIP are detailed, by external investment manager, in the following table:

Carrying Amount and Fair Value of Securities on Loan

|                                               | 2006                 |                      | 2005                 |                      |
|-----------------------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                               | Carrying<br>Amount   | Fair<br>Value        | Carrying<br>Amount   | Fair<br>Value        |
| <u>External Investment Manager</u>            |                      |                      |                      |                      |
| Schroder Investment Mgmt.                     | \$ 10,549,986        | \$ 12,246,945        | \$ 6,217,820         | \$ 7,804,614         |
| Pyford International                          | 0                    | 0                    | 8,367,610            | 11,720,776           |
| Nomura Asset Management U.S.A., Inc           | <u>14,863,093</u>    | <u>17,883,235</u>    | <u>11,360,634</u>    | <u>14,147,954</u>    |
| Total Investments on Loan                     | \$ <u>25,413,079</u> | \$ <u>30,130,180</u> | \$ <u>25,946,064</u> | \$ <u>33,673,344</u> |
| Securities Lending Collateral Investment Pool | \$ <u>31,330,825</u> | \$ <u>31,330,825</u> | \$ <u>34,537,173</u> | \$ <u>34,537,173</u> |

As of June 30, 2006, the collateral provided for the securities on loan totaled \$31,330,825 in cash and \$148,092 in securities collateral. As of June 30, 2005, the collateral provided for the securities on loan totaled \$34,537,173 in cash and \$779,936 in securities collateral.

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, all the MTIP securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The BGI MSCI Europe and Pacific Index and the DFA Small Company Portfolio are registered in the name of the Montana Board of Investments.

##### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The U.S. dollar balances of the MTIP cash and investments are disclosed by currency and investment type in the following table and Note 7 - Year End Portfolio for 2006.

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### MTIP Cash by Currency

|                    | 2006                |                     | 2005                |                     |
|--------------------|---------------------|---------------------|---------------------|---------------------|
|                    | Carrying<br>Amount  | Fair<br>Value       | Carrying<br>Amount  | Fair<br>Value       |
| <u>Cash</u>        |                     |                     |                     |                     |
| Australian Dollar  | \$ 66,735           | \$ 67,808           | \$ 132,456          | \$ 129,655          |
| Hong Kong Dollar   | 699,971             | 699,204             | 124,923             | 124,949             |
| France Euro        | 0                   | 0                   | 54                  | 54                  |
| Japanese Yen       | 1,304,411           | 1,317,040           | 1,458,770           | 1,437,714           |
| South Korean Won   | 23,893              | 24,146              | 4,185               | 4,085               |
| Malaysian Ringgit  | 8,722               | 8,722               | 7,189               | 7,189               |
| New Zealand Dollar | 0                   | 0                   | 69,938              | 67,755              |
| Philippine Peso    | 2,493               | 2,509               | 2,728               | 2,664               |
| Singapore Dollar   | 1,364,829           | 1,367,218           | 1,233               | 1,219               |
| New Taiwan Dollar  | <u>167,596</u>      | <u>168,231</u>      | <u>194,741</u>      | <u>193,214</u>      |
| Total Cash         | \$ <u>3,638,650</u> | \$ <u>3,654,878</u> | \$ <u>1,996,217</u> | \$ <u>1,968,498</u> |

### MTIP Investment by Security Type

|                                               | 2006                  |                         | 2005                  |                       |
|-----------------------------------------------|-----------------------|-------------------------|-----------------------|-----------------------|
|                                               | Carrying<br>Amount    | Fair<br>Value           | Carrying<br>Amount    | Fair<br>Value         |
| <u>Security Investment Type</u>               |                       |                         |                       |                       |
| BGI MSCI Europe Index                         | \$ 546,725,220        | \$ 768,768,601          | \$ 384,025,081        | \$ 466,246,669        |
| BGI MSCI Pacific Index                        | 40,005,323            | 65,943,278              | 40,005,322            | 50,628,249            |
| BGI Cash and Money Market                     | 1                     | 1                       | 1                     | 1                     |
| DFA International Small Company               | 78,148,695            | 93,071,030              | 75,484,090            | 76,554,040            |
| State Street ISPIFF/SPIFF                     | 28,001,021            | 30,495,834              | 2,123,299             | 2,111,305             |
| Schroder Investment Management                | 114,423,195           | 139,113,092             | 120,403,317           | 137,133,726           |
| Pyford International                          | 0                     | 0                       | 124,335,445           | 149,790,197           |
| Nomura Asset Management U.S.A.                | 105,769,398           | 143,656,505             | <u>93,755,428</u>     | <u>111,054,432</u>    |
| Total Investments                             | \$ <u>913,072,853</u> | \$ <u>1,241,048,341</u> | \$ <u>840,131,984</u> | \$ <u>993,518,620</u> |
| Securities Lending Collateral Investment Pool | <u>31,330,825</u>     | <u>31,330,825</u>       | <u>34,537,173</u>     | <u>34,537,173</u>     |

The MTIP, through the above funds, has significant investments in 11 foreign countries. Future economic and political developments in these countries could adversely affect the liquidity or value, or both, of the securities held by the above funds in which MTIP is invested.

### 5. MTIP POOL DIVERSIFICATION

On April 26, 2006, the Board approved a staff recommendation to diversify the Board's international equity exposure. The recommendation addresses an asset allocation policy change within the MTIP to accommodate a new structure. The pool restructuring involves the September 18, 2006 termination of Schroders and downsizing the other active Pacific region manager, Nomura. The BGI Passive Pacific Index Strategy fund will be eliminated. Exposure to the BGI Europe Equity Index fund and DFA International Small Company portfolio will also be reduced. These actions will result in funding nine new external managers in early October 2006. The new international external managers are listed as follows:

Acadian Asset Management  
Alliance/Bernstein  
AXA Rosenberg Investment Management  
Barclays Global Investors  
Batterymarch Financial Management

Hansberger Global Investors  
Julias Baer Investment Management  
Martin Currie  
Principal Global Investors

These managers were selected based on equity management styles of core, value and growth strategies. All non-U.S. countries will be represented in a broad international framework in this structure change. In April 2006, the Board approved the MSCI All Country World Index ex-US as the new benchmark for the international equity pool once pool restructure is complete.

## 6. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf. While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT down load function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

## 7. YEAR END PORTFOLIO

The combined MTIP investment portfolios for the six funds, as of June 30, 2006 are listed below by currency. The percent is based on the total fair value of each security/country to the combined total portfolio fair value.

| <u>Country</u>           | <u>Security Name</u>           | <u>Shares</u>    | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u>     |
|--------------------------|--------------------------------|------------------|-----------------------|-------------------|--------------|
| AUSTRALIAN DOLLAR        | ALUMINA LIMITED                | 199,874          | 889,563               | 1,001,406         | 0.08%        |
| AUSTRALIAN DOLLAR        | AUSTRALIA + NEW ZEALAND BANK   | 160,733          | 2,350,379             | 3,172,295         | 0.26%        |
| AUSTRALIAN DOLLAR        | AUSTRALIAN STOCK EXCHANGE      | 16,000           | 391,488               | 386,920           | 0.03%        |
| AUSTRALIAN DOLLAR        | BHP BILLITON LTD               | 217,010          | 1,261,304             | 4,671,194         | 0.38%        |
| AUSTRALIAN DOLLAR        | BLUESCOPE STEEL LTD            | 37,000           | 197,400               | 218,333           | 0.02%        |
| AUSTRALIAN DOLLAR        | BRADKEN LTD                    | 34,729           | 67,415                | 134,044           | 0.01%        |
| AUSTRALIAN DOLLAR        | BRAMBLES INDUSTRIES LTD        | 173,470          | 1,024,717             | 1,416,339         | 0.11%        |
| AUSTRALIAN DOLLAR        | COATES HIRE LTD                | 70,908           | 270,333               | 336,315           | 0.03%        |
| AUSTRALIAN DOLLAR        | COMMONWEALTH BANK OF AUSTRALIA | 38,300           | 1,063,890             | 1,262,495         | 0.10%        |
| AUSTRALIAN DOLLAR        | FOSTERS GROUP                  | 339,300          | 1,235,064             | 1,377,594         | 0.11%        |
| AUSTRALIAN DOLLAR        | HERALD RESOURCES               | 274,000          | 256,571               | 262,356           | 0.02%        |
| AUSTRALIAN DOLLAR        | INSURANCE AUSTRALIA GROUP      | 156,252          | 557,475               | 620,483           | 0.05%        |
| AUSTRALIAN DOLLAR        | LEND LEASE CORP                | 133,141          | 1,238,387             | 1,382,546         | 0.11%        |
| AUSTRALIAN DOLLAR        | MACQUARIE INFRASTRUCTURE GROUP | 304,069          | 808,447               | 758,336           | 0.06%        |
| AUSTRALIAN DOLLAR        | NATIONAL AUSTRALIA BANK        | 74,049           | 1,555,913             | 1,932,494         | 0.16%        |
| AUSTRALIAN DOLLAR        | ORIGIN ENERGY                  | 90,843           | 516,507               | 496,272           | 0.04%        |
| AUSTRALIAN DOLLAR        | PUBLISHING + BROADCASTING LTD  | 40,173           | 488,837               | 542,993           | 0.04%        |
| AUSTRALIAN DOLLAR        | QBE INSURANCE GROUP            | 58,000           | 735,684               | 882,535           | 0.07%        |
| AUSTRALIAN DOLLAR        | RINKER GROUP                   | 37,455           | 167,240               | 455,658           | 0.04%        |
| AUSTRALIAN DOLLAR        | RIO TINTO LIMITED              | 43,728           | 1,085,582             | 2,525,163         | 0.20%        |
| AUSTRALIAN DOLLAR        | SONIC HEALTHCARE LTD           | 50,500           | 461,412               | 532,267           | 0.04%        |
| AUSTRALIAN DOLLAR        | TELSTRA CORP                   | 135,394          | 436,504               | 369,826           | 0.03%        |
| AUSTRALIAN DOLLAR        | WESFARMERS                     | 49,020           | 1,322,996             | 1,285,485         | 0.10%        |
| AUSTRALIAN DOLLAR        | WESTFIELD GROUP                | 77,841           | 869,351               | 1,001,284         | 0.08%        |
| AUSTRALIAN DOLLAR        | WESTPAC BANKING CORP           | 258,942          | 2,983,534             | 4,474,409         | 0.36%        |
| AUSTRALIAN DOLLAR        | WOODSIDE PETROLEUM             | 15,866           | 157,491               | 518,168           | 0.04%        |
| AUSTRALIAN DOLLAR        | WOOLWORTHS LTD                 | 170,943          | 1,974,976             | 2,556,681         | 0.21%        |
| <b>AUSTRALIAN DOLLAR</b> | <b>27 ISSUE(S)</b>             | <b>3,257,540</b> | <b>24,368,460</b>     | <b>34,573,892</b> | <b>2.79%</b> |
| HONG KONG DOLLAR         | AGILE PROPERTY HOLDING         | 1,279,164        | 700,262               | 765,819           | 0.06%        |
| HONG KONG DOLLAR         | BANK OF CHINA LTD              | 517,000          | 215,786               | 234,637           | 0.02%        |
| HONG KONG DOLLAR         | BOC HONG KONG HOLDINGS LTD     | 286,000          | 573,629               | 559,701           | 0.05%        |
| HONG KONG DOLLAR         | CHEUNG KONG HOLDINGS           | 278,000          | 2,591,522             | 3,011,935         | 0.24%        |
| HONG KONG DOLLAR         | CHINA COSCO HOLDINGS           | 870,500          | 426,281               | 448,307           | 0.04%        |
| HONG KONG DOLLAR         | CHINA LIFE INSURANCE           | 370,000          | 248,636               | 583,559           | 0.05%        |

| <u>Country</u>           | <u>Security Name</u>        | <u>Shares</u>     | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u>     |
|--------------------------|-----------------------------|-------------------|-----------------------|-------------------|--------------|
| HONG KONG DOLLAR         | CHINA MOBILE LTD            | 230,000           | 823,864               | 1,314,793         | 0.11%        |
| HONG KONG DOLLAR         | CHINA OILFIELD SERVICE      | 312,000           | 148,693               | 158,671           | 0.01%        |
| HONG KONG DOLLAR         | CHINA OVERSEAS - WARRANTS   | 52,500            | 0                     | 1,521             | 0.00%        |
| HONG KONG DOLLAR         | CHINA OVERSEAS LAND         | 420,000           | 86,044                | 255,504           | 0.02%        |
| HONG KONG DOLLAR         | CHINA PETROLIUM + CHEMICAL  | 2,174,000         | 914,941               | 1,245,565         | 0.10%        |
| HONG KONG DOLLAR         | CHINA RESOURCES EN          | 378,000           | 683,732               | 771,379           | 0.06%        |
| HONG KONG DOLLAR         | CLP HOLDINGS                | 41,736            | 193,039               | 244,226           | 0.02%        |
| HONG KONG DOLLAR         | CNOOC LTD                   | 2,270,000         | 1,713,059             | 1,812,025         | 0.15%        |
| HONG KONG DOLLAR         | FU JI FOOD + CATER          | 384,000           | 690,592               | 632,831           | 0.05%        |
| HONG KONG DOLLAR         | GIORDANO INTERNATIONAL LTD  | 1,150,000         | 604,479               | 544,129           | 0.04%        |
| HONG KONG DOLLAR         | GOME ELECTRICAL AP          | 797,000           | 545,554               | 672,119           | 0.05%        |
| HONG KONG DOLLAR         | HANG LUNG PROP              | 306,000           | 487,243               | 547,625           | 0.04%        |
| HONG KONG DOLLAR         | HOPEWELL HIGHWAY            | 490,000           | 326,596               | 369,061           | 0.03%        |
| HONG KONG DOLLAR         | HSBC HOLDINGS               | 111,600           | 1,649,337             | 1,955,550         | 0.16%        |
| HONG KONG DOLLAR         | LI + FUNG                   | 242,600           | 390,748               | 490,385           | 0.04%        |
| HONG KONG DOLLAR         | MTR CORP                    | 113,243           | 176,005               | 273,375           | 0.02%        |
| HONG KONG DOLLAR         | PETROCHINA CO               | 500,000           | 475,808               | 534,312           | 0.04%        |
| HONG KONG DOLLAR         | PING AN INSURANCE           | 285,000           | 404,128               | 864,137           | 0.07%        |
| HONG KONG DOLLAR         | SUN HUNG KAI PROPS          | 135,520           | 1,288,837             | 1,381,896         | 0.11%        |
| HONG KONG DOLLAR         | SWIRE PACIFIC               | 174,500           | 1,226,728             | 1,800,718         | 0.15%        |
| HONG KONG DOLLAR         | WHARF HOLDINGS              | 240,000           | 821,760               | 852,839           | 0.07%        |
| HONG KONG DOLLAR         | ZIJIN MINING GROUP CO LTD   | 1,178,000         | 133,659               | 587,711           | 0.05%        |
| <b>HONG KONG DOLLAR</b>  | <b>28 ISSUE(S)</b>          | <b>15,586,363</b> | <b>18,540,963</b>     | <b>22,914,329</b> | <b>1.85%</b> |
| INDONESIAN RUPIAH        | INDOSAT                     | 545,000           | 308,272               | 251,525           | 0.02%        |
| INDONESIAN RUPIAH        | MEDCO ENERGI INTL           | 1,585,000         | 515,049               | 637,388           | 0.05%        |
| <b>INDONESIAN RUPIAH</b> | <b>2 ISSUE(S)</b>           | <b>2,130,000</b>  | <b>823,321</b>        | <b>888,913</b>    | <b>0.07%</b> |
| JAPANESE YEN             | AISIN SEIKI CO              | 53,700            | 828,888               | 1,594,516         | 0.13%        |
| JAPANESE YEN             | AMADA CO                    | 64,000            | 387,759               | 670,713           | 0.05%        |
| JAPANESE YEN             | ASAHI GLASS CO              | 145,000           | 1,666,797             | 1,837,431         | 0.15%        |
| JAPANESE YEN             | ASAHI KASEI CORP            | 256,000           | 1,249,414             | 1,670,076         | 0.13%        |
| JAPANESE YEN             | ASTELLAS PHARMACEUTICAL INC | 100,900           | 3,441,209             | 3,700,974         | 0.30%        |
| JAPANESE YEN             | BANK OF YOKOHAMA            | 74,000            | 319,433               | 571,940           | 0.05%        |
| JAPANESE YEN             | BENESSE CORP                | 14,700            | 514,584               | 507,096           | 0.04%        |
| JAPANESE YEN             | BRIDGESTONE CORP            | 148,900           | 2,183,993             | 2,867,338         | 0.23%        |
| JAPANESE YEN             | CANON INC                   | 31,800            | 1,059,349             | 1,557,993         | 0.13%        |
| JAPANESE YEN             | CANON MARKETING JA          | 24,000            | 186,740               | 494,651           | 0.04%        |
| JAPANESE YEN             | CENTRAL GLASS CO            | 62,000            | 364,560               | 368,735           | 0.03%        |
| JAPANESE YEN             | CENTRAL JAPAN RAILWAY       | 152               | 1,203,131             | 1,513,296         | 0.12%        |
| JAPANESE YEN             | CHIYODA CO                  | 5,800             | 155,615               | 127,645           | 0.01%        |
| JAPANESE YEN             | CREDIT SAISON CO            | 31,900            | 672,357               | 1,509,960         | 0.12%        |
| JAPANESE YEN             | DAICEL CHEMICAL INDUSTRIES  | 50,000            | 336,063               | 408,279           | 0.03%        |
| JAPANESE YEN             | DAIDO STEEL CO              | 146,000           | 239,736               | 1,144,998         | 0.09%        |
| JAPANESE YEN             | DAIICHI SANKYO              | 27,500            | 500,155               | 756,517           | 0.06%        |
| JAPANESE YEN             | DAIKIN INDUSTRIES           | 77,900            | 1,799,642             | 2,700,869         | 0.22%        |
| JAPANESE YEN             | DAINIPPON SCREEN            | 44,000            | 374,321               | 402,707           | 0.03%        |
| JAPANESE YEN             | DAITO TRUST CONSTRUCTION    | 6,700             | 323,005               | 370,971           | 0.03%        |
| JAPANESE YEN             | DENKI KAGAKU KOGYO          | 220,000           | 656,793               | 914,545           | 0.07%        |
| JAPANESE YEN             | DOWA MINING CO              | 182,000           | 858,252               | 1,608,524         | 0.13%        |
| JAPANESE YEN             | EAST JAPAN RAILWAY          | 508               | 2,474,690             | 3,771,014         | 0.30%        |
| JAPANESE YEN             | ELPIDA MEMORY INC           | 26,900            | 828,270               | 1,010,174         | 0.08%        |
| JAPANESE YEN             | FAITH INC                   | 452               | 179,182               | 122,370           | 0.01%        |
| JAPANESE YEN             | FANUC                       | 8,300             | 522,710               | 745,155           | 0.06%        |
| JAPANESE YEN             | FUJI SEAL INTERNATIONAL INC | 14,200            | 445,985               | 373,276           | 0.03%        |
| JAPANESE YEN             | FUJIKURA                    | 78,000            | 350,532               | 860,347           | 0.07%        |
| JAPANESE YEN             | FUJITSU                     | 443,000           | 2,650,945             | 3,431,649         | 0.28%        |
| JAPANESE YEN             | FUNAI ELECTRIC CO           | 17,200            | 1,849,551             | 1,667,351         | 0.13%        |
| JAPANESE YEN             | GLORY                       | 7,000             | 76,276                | 134,492           | 0.01%        |
| JAPANESE YEN             | HI LEX CORPORATION          | 16,000            | 142,971               | 273,176           | 0.02%        |
| JAPANESE YEN             | HIROSHIMA BANK              | 50,000            | 286,103               | 304,354           | 0.02%        |
| JAPANESE YEN             | HITACHI CAP CORP            | 11,600            | 228,417               | 202,611           | 0.02%        |
| JAPANESE YEN             | HITACHI CHEMICAL            | 27,100            | 571,386               | 710,013           | 0.06%        |
| JAPANESE YEN             | HITACHI HIGH TECH           | 12,400            | 223,864               | 376,857           | 0.03%        |

| <u>Country</u> | <u>Security Name</u>         | <u>Shares</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|----------------|------------------------------|---------------|-----------------------|-------------------|----------|
| JAPANESE YEN   | HITACHI INFO SYSTEM          | 17,800        | 404,733               | 424,383           | 0.03%    |
| JAPANESE YEN   | HITACHI METALS               | 51,000        | 251,142               | 501,070           | 0.04%    |
| JAPANESE YEN   | HITACHI TRANSPORT SYSTEM     | 93,000        | 523,195               | 934,833           | 0.08%    |
| JAPANESE YEN   | HONDA MOTOR CO               | 54,200        | 1,077,334             | 1,718,231         | 0.14%    |
| JAPANESE YEN   | IBIDEN CO                    | 7,400         | 347,415               | 355,443           | 0.03%    |
| JAPANESE YEN   | ITOCHU CORP                  | 229,000       | 565,836               | 2,009,912         | 0.16%    |
| JAPANESE YEN   | ITOCHU TECHNO SCIENCE        | 5,500         | 149,631               | 253,133           | 0.02%    |
| JAPANESE YEN   | JAPAN AIRPORT TERMINAL       | 59,300        | 455,658               | 644,762           | 0.05%    |
| JAPANESE YEN   | JFE HOLDING INC              | 86,800        | 1,595,982             | 3,676,521         | 0.30%    |
| JAPANESE YEN   | JS GROUP CORP                | 58,200        | 958,606               | 1,222,401         | 0.10%    |
| JAPANESE YEN   | KAJIMA CORP                  | 111,000       | 509,318               | 508,930           | 0.04%    |
| JAPANESE YEN   | KAKEN PHARMACEUTICAL         | 9,000         | 61,290                | 67,517            | 0.01%    |
| JAPANESE YEN   | KAMIGUMI CO                  | 82,000        | 570,356               | 622,313           | 0.05%    |
| JAPANESE YEN   | KANEKA CORP                  | 77,000        | 714,667               | 699,358           | 0.06%    |
| JAPANESE YEN   | KDDI CORP                    | 357           | 1,864,604             | 2,191,791         | 0.18%    |
| JAPANESE YEN   | KEIHIN CORP                  | 25,400        | 241,736               | 544,579           | 0.04%    |
| JAPANESE YEN   | KEYENCE CORP                 | 4,800         | 1,100,433             | 1,224,890         | 0.10%    |
| JAPANESE YEN   | KOBAYASHI PHARMACEUTICAL     | 4,300         | 131,820               | 175,748           | 0.01%    |
| JAPANESE YEN   | KYOCERA CORP                 | 15,400        | 1,042,450             | 1,191,599         | 0.10%    |
| JAPANESE YEN   | LEOPALACE21                  | 19,000        | 425,628               | 655,430           | 0.05%    |
| JAPANESE YEN   | MABUCHI MOTOR CO             | 4,600         | 331,273               | 274,783           | 0.02%    |
| JAPANESE YEN   | MAKITA CORP                  | 18,500        | 539,172               | 584,865           | 0.05%    |
| JAPANESE YEN   | MARUI CO                     | 69,400        | 1,129,865             | 1,080,047         | 0.09%    |
| JAPANESE YEN   | MAZDA MOTOR CORP             | 88,000        | 535,190               | 551,033           | 0.04%    |
| JAPANESE YEN   | MISUMI GROUP INC             | 19,600        | 320,088               | 366,307           | 0.03%    |
| JAPANESE YEN   | mitsubishi electric          | 169,000       | 602,948               | 1,353,417         | 0.11%    |
| JAPANESE YEN   | MITSUBISHI ESTATE            | 73,000        | 844,045               | 1,549,190         | 0.12%    |
| JAPANESE YEN   | MITSUBISHI UFJ FIN GROUP     | 583           | 5,952,079             | 8,146,369         | 0.66%    |
| JAPANESE YEN   | MITSUBISHI UFJ SECURITIES CO | 62,000        | 908,344               | 799,197           | 0.06%    |
| JAPANESE YEN   | MITSUI + CO                  | 182,000       | 1,097,943             | 2,568,552         | 0.21%    |
| JAPANESE YEN   | MITSUI FUDOSAN CO            | 17,000        | 149,745               | 368,936           | 0.03%    |
| JAPANESE YEN   | MITSUI MINING + SM           | 70,000        | 381,036               | 412,646           | 0.03%    |
| JAPANESE YEN   | MIZUHO FINANCIAL             | 90            | 722,368               | 761,626           | 0.06%    |
| JAPANESE YEN   | MODEC INC                    | 8,600         | 234,360               | 192,271           | 0.02%    |
| JAPANESE YEN   | NAMCO BANDAI HOLDINGS        | 43,300        | 620,326               | 657,602           | 0.05%    |
| JAPANESE YEN   | NET ONE SYSTEMS CO           | 306           | 627,034               | 569,215           | 0.05%    |
| JAPANESE YEN   | NICHICON CORP                | 4,800         | 289,145               | 59,274            | 0.00%    |
| JAPANESE YEN   | NIDEC CORPORATION            | 15,300        | 1,170,963             | 1,095,673         | 0.09%    |
| JAPANESE YEN   | NIHON UNISYS                 | 28,800        | 305,449               | 477,380           | 0.04%    |
| JAPANESE YEN   | NINTENDO CO                  | 7,200         | 660,390               | 1,207,284         | 0.10%    |
| JAPANESE YEN   | NIPPON CHEMI CON             | 7,000         | 43,643                | 44,505            | 0.00%    |
| JAPANESE YEN   | NIPPON OIL CORP              | 104,000       | 519,677               | 759,303           | 0.06%    |
| JAPANESE YEN   | NIPPON PAPER GROUP INC       | 178           | 895,673               | 727,514           | 0.06%    |
| JAPANESE YEN   | NIPPON SUISAN                | 63,000        | 134,116               | 318,012           | 0.03%    |
| JAPANESE YEN   | NIPPON TEL+TEL               | 652           | 3,948,049             | 3,194,376         | 0.26%    |
| JAPANESE YEN   | NIPPON TV NETWORK            | 2,940         | 564,919               | 399,771           | 0.03%    |
| JAPANESE YEN   | NIPPON YUSEN KK              | 86,000        | 311,925               | 558,788           | 0.05%    |
| JAPANESE YEN   | NISHIMATSUYA CHAIN           | 10,700        | 132,367               | 206,982           | 0.02%    |
| JAPANESE YEN   | NISSAN MOTOR CO              | 533,000       | 5,802,837             | 5,818,523         | 0.47%    |
| JAPANESE YEN   | NISSIN CO                    | 403,800       | 124,229               | 282,119           | 0.02%    |
| JAPANESE YEN   | NITTO DENKO CORP             | 18,800        | 1,026,688             | 1,338,108         | 0.11%    |
| JAPANESE YEN   | NOMURA HOLDINGS              | 86,000        | 1,188,208             | 1,611,021         | 0.13%    |
| JAPANESE YEN   | NTN CORP                     | 50,000        | 295,790               | 395,179           | 0.03%    |
| JAPANESE YEN   | NTT DOCOMO                   | 440           | 1,086,580             | 645,561           | 0.05%    |
| JAPANESE YEN   | OMRON CORP                   | 85,000        | 1,635,553             | 2,163,879         | 0.17%    |
| JAPANESE YEN   | ONO PHARMACEUTICAL           | 7,600         | 309,178               | 369,696           | 0.03%    |
| JAPANESE YEN   | ORIX CORP                    | 6,960         | 422,323               | 1,698,895         | 0.14%    |
| JAPANESE YEN   | OSG CORP                     | 16,000        | 207,388               | 269,263           | 0.02%    |
| JAPANESE YEN   | PARIS MIKI INC               | 17,200        | 318,847               | 358,255           | 0.03%    |
| JAPANESE YEN   | PLENUS CO                    | 6,700         | 214,947               | 228,200           | 0.02%    |
| JAPANESE YEN   | PROMISE CO                   | 25,000        | 1,354,407             | 1,447,535         | 0.12%    |
| JAPANESE YEN   | RICOH CO                     | 115,000       | 2,027,331             | 2,254,705         | 0.18%    |

| <u>Country</u>           | <u>Security Name</u>           | <u>Shares</u>    | <u>Carrying Value</u> | <u>Fair Value</u>  | <u>%</u>      |
|--------------------------|--------------------------------|------------------|-----------------------|--------------------|---------------|
| JAPANESE YEN             | ROHM CO                        | 44,600           | 5,153,423             | 3,984,612          | 0.32%         |
| JAPANESE YEN             | SANKEN ELECTRIC CO             | 39,000           | 351,753               | 495,908            | 0.04%         |
| JAPANESE YEN             | SANKYO TATETAMA HO             | 126,000          | 384,234               | 277,298            | 0.02%         |
| JAPANESE YEN             | SANYO SHOKAI                   | 37,000           | 243,552               | 268,198            | 0.02%         |
| JAPANESE YEN             | SEIKO CORPORATION              | 19,000           | 90,125                | 179,538            | 0.01%         |
| JAPANESE YEN             | SEKISUI CHEMICAL               | 140,000          | 944,002               | 1,207,982          | 0.10%         |
| JAPANESE YEN             | SEVEN + I HOLDINGS             | 92,500           | 2,875,412             | 3,045,500          | 0.25%         |
| JAPANESE YEN             | SHIMACHU CO                    | 13,200           | 310,969               | 344,684            | 0.03%         |
| JAPANESE YEN             | SHIMADZU CORP                  | 139,000          | 830,591               | 984,490            | 0.08%         |
| JAPANESE YEN             | SHIMAMURA CO                   | 4,700            | 504,669               | 514,720            | 0.04%         |
| JAPANESE YEN             | SHIN ETSU CHEM CO              | 20,200           | 1,154,028             | 1,097,280          | 0.09%         |
| JAPANESE YEN             | SHIONOGI + CO                  | 53,000           | 735,946               | 944,238            | 0.08%         |
| JAPANESE YEN             | SHOWA DENKO KK                 | 338,000          | 697,275               | 1,502,485          | 0.12%         |
| JAPANESE YEN             | SOMPO JAPAN INSURANCE          | 135,000          | 1,105,386             | 1,886,381          | 0.15%         |
| JAPANESE YEN             | STANLEY ELECTRIC               | 56,900           | 933,165               | 1,172,735          | 0.09%         |
| JAPANESE YEN             | SUMITOMO ELECTRIC INDUSTRIES   | 94,000           | 783,937               | 1,375,870          | 0.11%         |
| JAPANESE YEN             | SUMITOMO HEAVY INDUSTRIES      | 73,000           | 627,654               | 674,503            | 0.05%         |
| JAPANESE YEN             | SUMITOMO MITSUI GROUP          | 756              | 5,692,600             | 7,988,821          | 0.64%         |
| JAPANESE YEN             | SUMITOMO RUBBER                | 57,800           | 751,030               | 635,520            | 0.05%         |
| JAPANESE YEN             | SUMITOMO TRUST+BANKING         | 172,000          | 1,012,641             | 1,877,647          | 0.15%         |
| JAPANESE YEN             | T+D HOLDINGS INC               | 33,200           | 1,656,594             | 2,681,979          | 0.22%         |
| JAPANESE YEN             | TAKEDA PHARMACEUTICAL CO LTD   | 46,600           | 1,844,578             | 2,897,620          | 0.23%         |
| JAPANESE YEN             | TAKEFUJI CORP                  | 12,690           | 901,142               | 755,826            | 0.06%         |
| JAPANESE YEN             | TDK CORP                       | 30,500           | 2,132,541             | 2,317,366          | 0.19%         |
| JAPANESE YEN             | THK CO                         | 50,500           | 927,028               | 1,503,908          | 0.12%         |
| JAPANESE YEN             | TIS INC                        | 16,000           | 450,850               | 447,142            | 0.04%         |
| JAPANESE YEN             | TOKAI RUBBER INDUSTRIES        | 9,400            | 123,378               | 143,662            | 0.01%         |
| JAPANESE YEN             | TOKYO GAS CO                   | 92,000           | 386,159               | 433,064            | 0.03%         |
| JAPANESE YEN             | TOKYO SEIMITSU CO              | 21,900           | 657,601               | 1,136,073          | 0.09%         |
| JAPANESE YEN             | TOKYO STEEL MFG                | 19,100           | 304,298               | 417,846            | 0.03%         |
| JAPANESE YEN             | TOSHIBA CORP                   | 219,000          | 1,190,055             | 1,428,697          | 0.12%         |
| JAPANESE YEN             | TOSOH CORP                     | 108,000          | 554,243               | 430,095            | 0.03%         |
| JAPANESE YEN             | TOYO SUISAN KAISHA             | 18,000           | 185,906               | 281,699            | 0.02%         |
| JAPANESE YEN             | TOYODA GOSEI                   | 10,400           | 184,628               | 208,445            | 0.02%         |
| JAPANESE YEN             | TOYOTA MOTOR CORP              | 108,200          | 3,051,587             | 5,660,172          | 0.46%         |
| JAPANESE YEN             | ULVACINC                       | 7,200            | 195,835               | 245,858            | 0.02%         |
| JAPANESE YEN             | UNITED ARROWS LTD              | 18,000           | 190,338               | 355,268            | 0.03%         |
| JAPANESE YEN             | USHIO INC                      | 50,100           | 922,769               | 1,056,648          | 0.09%         |
| JAPANESE YEN             | USS                            | 8,530            | 578,211               | 563,179            | 0.05%         |
| JAPANESE YEN             | VICTOR CO OF JAPAN             | 122,000          | 1,027,782             | 617,964            | 0.05%         |
| JAPANESE YEN             | YAMAHA CORP                    | 80,200           | 1,350,713             | 1,505,873          | 0.12%         |
| JAPANESE YEN             | YAMATO HOLDINGS CO LTD         | 13,000           | 228,329               | 230,470            | 0.02%         |
| JAPANESE YEN             | YOKOGAWA ELECTRIC              | 42,100           | 582,582               | 599,669            | 0.05%         |
| JAPANESE YEN             | YORK BENIMARU CO               | 14,000           | 322,948               | 399,808            | 0.03%         |
| <b>JAPANESE YEN</b>      | <b>142 ISSUE(S)</b>            | <b>8,824,394</b> | <b>128,263,438</b>    | <b>165,848,053</b> | <b>13.36%</b> |
| MALAYSIAN RINGGIT        | ASTRO ALL ASIA NET             | 271,100          | 382,950               | 333,480            | 0.03%         |
| MALAYSIAN RINGGIT        | BUMIPUTRA COMMERCE HOLDINGS BH | 376,600          | 561,925               | 609,816            | 0.05%         |
| MALAYSIAN RINGGIT        | GENTING BERHAD                 | 77,100           | 357,676               | 497,284            | 0.04%         |
| MALAYSIAN RINGGIT        | HIGHLANDS+LOWLANDS             | 120,000          | 129,647               | 135,855            | 0.01%         |
| MALAYSIAN RINGGIT        | LAFARGE MALAYAN CEMENT BHD     | 1,200,000        | 230,556               | 241,666            | 0.02%         |
| MALAYSIAN RINGGIT        | MALAYAN BANK BHD               | 93,200           | 236,887               | 271,395            | 0.02%         |
| MALAYSIAN RINGGIT        | MISC BHD                       | 135,900          | 256,528               | 284,782            | 0.02%         |
| MALAYSIAN RINGGIT        | RHB CAPITAL BHD                | 270,000          | 180,135               | 202,068            | 0.02%         |
| MALAYSIAN RINGGIT        | SCOMI GROUP BERHAD             | 587,000          | 176,520               | 172,530            | 0.01%         |
| MALAYSIAN RINGGIT        | SHELL REFINERY                 | 92,300           | 266,052               | 253,703            | 0.02%         |
| MALAYSIAN RINGGIT        | UMW HOLDINGS BERHAD            | 100,000          | 207,191               | 205,470            | 0.02%         |
| <b>MALAYSIAN RINGGIT</b> | <b>11 ISSUE(S)</b>             | <b>3,323,200</b> | <b>2,986,066</b>      | <b>3,208,048</b>   | <b>0.26%</b>  |
| NEW TAIWAN DOLLAR        | ACER INC                       | 27,000           | 300,700               | 237,600            | 0.02%         |
| NEW TAIWAN DOLLAR        | ACER INC                       | 476,960          | 908,938               | 838,413            | 0.07%         |
| NEW TAIWAN DOLLAR        | ADVANTECH                      | 82,559           | 176,463               | 236,688            | 0.02%         |
| NEW TAIWAN DOLLAR        | ASUSTEK COMPUTER               | 120,000          | 347,651               | 294,722            | 0.02%         |
| NEW TAIWAN DOLLAR        | AU OPTRONIC'S CORP             | 17,725           | 226,847               | 252,404            | 0.02%         |

| <u>Country</u>            | <u>Security Name</u>           | <u>Shares</u>    | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u>     |
|---------------------------|--------------------------------|------------------|-----------------------|-------------------|--------------|
| NEW TAIWAN DOLLAR         | AU OPTRONICS CORP              | 289,120          | 398,116               | 408,186           | 0.03%        |
| NEW TAIWAN DOLLAR         | CATCHER TECHNOLOGY CO LTD      | 63,000           | 480,765               | 667,573           | 0.05%        |
| NEW TAIWAN DOLLAR         | CATHAY FINANCIAL               | 519,000          | 1,063,400             | 1,135,180         | 0.09%        |
| NEW TAIWAN DOLLAR         | CATHAY FINANCIAL HOLDING       | 35,080           | 576,014               | 754,220           | 0.06%        |
| NEW TAIWAN DOLLAR         | CHINA STEEL                    | 26,735           | 326,566               | 529,353           | 0.04%        |
| NEW TAIWAN DOLLAR         | CHINA TRUST FINANCE            | 399,597          | 349,268               | 331,460           | 0.03%        |
| NEW TAIWAN DOLLAR         | DELTA ELECTRONICS              | 134,610          | 165,198               | 382,586           | 0.03%        |
| NEW TAIWAN DOLLAR         | FAR EASTONE TELECOMMUNICATIONS | 40,941           | 723,001               | 693,950           | 0.06%        |
| NEW TAIWAN DOLLAR         | FORMOSA INTERNATIONAL HOTEL    | 70,000           | 173,310               | 180,139           | 0.01%        |
| NEW TAIWAN DOLLAR         | FORMOSA PLASTIC                | 295,500          | 429,044               | 448,232           | 0.04%        |
| NEW TAIWAN DOLLAR         | FUBON FINANCIAL HOLDING CO     | 22,275           | 209,135               | 194,906           | 0.02%        |
| NEW TAIWAN DOLLAR         | GLANT MANUFACTURIN             | 159,000          | 276,819               | 257,390           | 0.02%        |
| NEW TAIWAN DOLLAR         | HON HAI PRECISION              | 264,132          | 1,412,683             | 1,631,981         | 0.13%        |
| NEW TAIWAN DOLLAR         | HON HAI PRECISION INDUSTRIES   | 80,192           | 524,659               | 971,927           | 0.08%        |
| NEW TAIWAN DOLLAR         | JOHNSON HEALTH TEC             | 46,000           | 214,976               | 251,533           | 0.02%        |
| NEW TAIWAN DOLLAR         | MEDIATEK INC                   | 54,000           | 559,250               | 500,471           | 0.04%        |
| NEW TAIWAN DOLLAR         | MERRY ELECTRONICS              | 50,723           | 118,223               | 154,506           | 0.01%        |
| NEW TAIWAN DOLLAR         | NAN YA PLASTIC                 | 150,000          | 226,220               | 221,273           | 0.02%        |
| NEW TAIWAN DOLLAR         | TAIWAN SECOM CO                | 131,800          | 142,943               | 241,861           | 0.02%        |
| NEW TAIWAN DOLLAR         | TAIWAN SEMICON MAN             | 1,113,659        | 1,823,018             | 2,009,227         | 0.16%        |
| NEW TAIWAN DOLLAR         | TONG YANG INDUSTRY             | 1,075,000        | 1,279,236             | 1,012,913         | 0.08%        |
| NEW TAIWAN DOLLAR         | UNITED MICRO ELECTRIC          | 1,026,561        | 629,516               | 615,248           | 0.05%        |
| <b>NEW TAIWAN DOLLAR</b>  | <b>27 ISSUE(S)</b>             | <b>6,771,169</b> | <b>14,061,960</b>     | <b>15,453,944</b> | <b>1.25%</b> |
| NEW ZEALAND DOLLAR        | TELECOM CORP OF NEW ZEALAND    | 167,008          | 676,552               | 411,237           | 0.03%        |
| <b>NEW ZEALAND DOLLAR</b> | <b>1 ISSUE(S)</b>              | <b>167,008</b>   | <b>676,552</b>        | <b>411,237</b>    | <b>0.03%</b> |
| PHILIPPINE PESO           | AYALA LAND INC                 | 6,313,976        | 817,573               | 1,369,239         | 0.11%        |
| PHILIPPINE PESO           | BCO DE ORO UNIV BANK           | 270,000          | 163,562               | 157,835           | 0.01%        |
| <b>PHILIPPINE PESO</b>    | <b>2 ISSUE(S)</b>              | <b>6,583,976</b> | <b>981,135</b>        | <b>1,527,074</b>  | <b>0.12%</b> |
| SINGAPORE DOLLAR          | CAPITALAND                     | 96,000           | 180,420               | 272,813           | 0.02%        |
| SINGAPORE DOLLAR          | CITY DEVELOPMENTS              | 79,000           | 341,448               | 466,467           | 0.04%        |
| SINGAPORE DOLLAR          | DBS GROUP HOLDINGS             | 104,266          | 853,053               | 1,191,800         | 0.10%        |
| SINGAPORE DOLLAR          | FRASER + NEAVE LTD             | 65,000           | 146,038               | 164,193           | 0.01%        |
| SINGAPORE DOLLAR          | JARDINE CYCLE + CARRIAGE LTD   | 106,000          | 755,208               | 669,403           | 0.05%        |
| SINGAPORE DOLLAR          | JARDINE MATHESON               | 62,800           | 1,126,033             | 1,105,280         | 0.09%        |
| SINGAPORE DOLLAR          | MOBILEONE                      | 260,560          | 209,577               | 340,612           | 0.03%        |
| SINGAPORE DOLLAR          | OVERSEAS CHINESE BANK          | 69,200           | 217,811               | 288,424           | 0.02%        |
| SINGAPORE DOLLAR          | SEMBCORP INDUSTRIES            | 155,000          | 279,011               | 317,146           | 0.03%        |
| SINGAPORE DOLLAR          | SINGAPORE AIRLINES             | 20,000           | 136,923               | 160,404           | 0.01%        |
| SINGAPORE DOLLAR          | SINGAPORE PRESS HD             | 242,768          | 661,723               | 631,641           | 0.05%        |
| SINGAPORE DOLLAR          | SINGAPORE TECH ENG             | 120,000          | 144,839               | 219,009           | 0.02%        |
| SINGAPORE DOLLAR          | SINGAPORE TELECOMM             | 567,580          | 837,689               | 910,422           | 0.07%        |
| SINGAPORE DOLLAR          | TAN CHONG INTERNATIONAL        | 620,000          | 138,746               | 140,492           | 0.01%        |
| SINGAPORE DOLLAR          | UNITED OVERSEAS BANK           | 68,576           | 456,654               | 675,583           | 0.05%        |
| SINGAPORE DOLLAR          | UOL GROUP LTD                  | 203,700          | 300,461               | 367,908           | 0.03%        |
| <b>SINGAPORE DOLLAR</b>   | <b>16 ISSUE(S)</b>             | <b>2,840,450</b> | <b>6,785,635</b>      | <b>7,921,597</b>  | <b>0.64%</b> |
| SOUTH KOREAN WON          | DACOM CORP                     | 24,000           | 423,324               | 424,980           | 0.03%        |
| SOUTH KOREAN WON          | DAEWOO SECURITIES              | 25,000           | 288,716               | 384,717           | 0.03%        |
| SOUTH KOREAN WON          | DAEWOO SHIPBUILDING + MARINE   | 51,330           | 1,262,075             | 1,509,467         | 0.12%        |
| SOUTH KOREAN WON          | GS ENGINEERING                 | 11,200           | 568,070               | 724,827           | 0.06%        |
| SOUTH KOREAN WON          | HANA FINANCIAL HOLDINGS        | 36,461           | 1,399,573             | 1,714,003         | 0.14%        |
| SOUTH KOREAN WON          | HITE BREWERY CO                | 14,847           | 1,866,683             | 1,485,091         | 0.12%        |
| SOUTH KOREAN WON          | HYUNDAI MIPO DOCK              | 3,870            | 361,376               | 387,510           | 0.03%        |
| SOUTH KOREAN WON          | HYUNDAI MOBIS                  | 5,500            | 465,350               | 465,507           | 0.04%        |
| SOUTH KOREAN WON          | HYUNDAI MOTOR CO               | 20,159           | 1,477,099             | 1,712,585         | 0.14%        |
| SOUTH KOREAN WON          | KOOKMIN BANK                   | 18,750           | 935,272               | 1,541,502         | 0.12%        |
| SOUTH KOREAN WON          | KT + G CORPORATION             | 6,862            | 116,880               | 400,690           | 0.03%        |
| SOUTH KOREAN WON          | LG ELECTRONICS INC             | 4,000            | 262,729               | 242,424           | 0.02%        |
| SOUTH KOREAN WON          | LG PHILIPS LCD CO LTD          | 76,175           | 1,580,004             | 1,380,291         | 0.11%        |
| SOUTH KOREAN WON          | POSCO                          | 3,361            | 425,081               | 901,581           | 0.07%        |
| SOUTH KOREAN WON          | SAMSUNG ELECTRONIC             | 10,953           | 3,175,042             | 6,961,432         | 0.56%        |
| SOUTH KOREAN WON          | SAMSUNG FIRE + MAR             | 6,400            | 537,695               | 860,079           | 0.07%        |

| <u>Country</u>              | <u>Security Name</u>            | <u>Shares</u>      | <u>Carrying Value</u> | <u>Fair Value</u>   | <u>%</u>       |
|-----------------------------|---------------------------------|--------------------|-----------------------|---------------------|----------------|
| SOUTH KOREAN WON            | SHINHAN FINANCIAL               | 15,216             | 311,162               | 713,689             | 0.06%          |
| SOUTH KOREAN WON            | SHINSEGAE CO LTD                | 2,489              | 770,051               | 1,246,140           | 0.10%          |
| SOUTH KOREAN WON            | WOONGJIN THINKBIG CO LTD        | 14,000             | 202,343               | 239,789             | 0.02%          |
| <b>SOUTH KOREAN WON</b>     | <b>19 ISSUE(S)</b>              | <b>350,573</b>     | <b>16,428,525</b>     | <b>23,296,305</b>   | <b>1.88%</b>   |
| THAILAND BAHT               | ADVANCED INFO SERV              | 372,600            | 959,715               | 878,774             | 0.07%          |
| THAILAND BAHT               | BANGKOK BANK                    | 519,600            | 1,426,103             | 1,443,333           | 0.12%          |
| THAILAND BAHT               | KASIKORNBANK PCL                | 190,000            | 292,997               | 293,763             | 0.02%          |
| THAILAND BAHT               | PTT EXPLORTN + PRD              | 279,000            | 259,353               | 775,000             | 0.06%          |
| THAILAND BAHT               | SIAM CEMENT CO                  | 161,300            | 952,022               | 972,196             | 0.08%          |
| THAILAND BAHT               | TISCO FINANCE THB10(NVDR)       | 359,200            | 232,176               | 208,969             | 0.02%          |
| THAILAND BAHT               | TRUE CORPORATION PUBLIC CO LTD  | 130,895            | 0                     | 0                   | 0.00%          |
| <b>THAILAND BAHT</b>        | <b>7 ISSUE(S)</b>               | <b>2,012,595</b>   | <b>4,122,367</b>      | <b>4,572,035</b>    | <b>0.37%</b>   |
| US DOLLAR                   | BGI EQUITY INDEX FUND EUROPE    | 60,418,608         | 546,725,220           | 768,768,601         | 61.95%         |
| US DOLLAR                   | BGI PACIFIC INDEX STRATEGY FUND | 3,578,423          | 40,005,322            | 65,943,278          | 5.31%          |
| US DOLLAR                   | DFA INTERNATIONAL SMALL CO      | 5,303,193          | 78,148,695            | 93,071,030          | 7.50%          |
| US DOLLAR                   | BGI MONEY MARKET FUND           | 1                  | 1                     | 1                   | 0.00%          |
| <b>US DOLLAR</b>            | <b>4 ISSUE(S)</b>               | <b>69,300,224</b>  | <b>664,879,239</b>    | <b>927,782,910</b>  | <b>74.76%</b>  |
| <b>EQUITY TOTAL</b>         | <b>286 ISSUE(S)</b>             | <b>121,147,492</b> | <b>882,917,662</b>    | <b>1,208,398,33</b> | <b>97.37%</b>  |
| US DOLLAR                   | EAFE STOCK PERFORMANCE INDEX    | 1,218,712          | 28,001,021            | 30,495,834          | 2.46%          |
| <b>EQUITY FUTURES TOTAL</b> | <b>1 ISSUE(S)</b>               | <b>1,218,712</b>   | <b>28,001,021</b>     | <b>30,495,834</b>   | <b>2.46%</b>   |
| UNITED STATES               | STATE STREET BANK + TRUST CO    | 2,154,170          | 2,154,170             | 2,154,170           | 0.17%          |
| <b>CASH TOTAL</b>           | <b>1 ISSUE(S)</b>               | <b>2,154,170</b>   | <b>2,154,170</b>      | <b>2,154,170</b>    | <b>0.17%</b>   |
| <b>Total MTIP</b>           | <b>288 ISSUE(S)</b>             | <b>124,520,375</b> | <b>913,072,853</b>    | <b>1,241,048,34</b> | <b>100.00%</b> |

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Real Estate Pool, as of June 30, 2006, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal year then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Real Estate Pool, as of June 30, 2006, and its changes in net asset value and investment income and distribution for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA REAL ESTATE POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2006

|                                                                                               |    | <u>2006</u>       |
|-----------------------------------------------------------------------------------------------|----|-------------------|
| <u>Assets</u>                                                                                 |    |                   |
| Cash                                                                                          | \$ | 0                 |
| Investments managed at fair value (amortized cost of \$30,159,689 in 2006)<br>(Notes 2 and 4) |    | <u>30,159,689</u> |
| Total assets                                                                                  | \$ | <u>30,159,689</u> |
| <u>Liabilities</u>                                                                            |    |                   |
| Income due participants (Note 2)                                                              |    | <u>124,689</u>    |
| Total liabilities                                                                             |    | <u>124,689</u>    |
| Net asset value                                                                               | \$ | <u>30,035,000</u> |
| Units Outstanding (Note 2)                                                                    |    | 300,350           |
| Unit Value (Note 2)                                                                           | \$ | 100.00            |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

|                                              |    |                   |
|----------------------------------------------|----|-------------------|
| Net asset value, beginning of year           | \$ | 0                 |
| Value of units purchased by participants     |    | 30,035,000        |
| Value of units sold by participants          |    | 0                 |
| Changes in fair value of investments managed |    | <u>0</u>          |
| Net asset value, end of year                 | \$ | <u>30,035,000</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

|                                               |    |                |
|-----------------------------------------------|----|----------------|
| Interest income (Note 2 )                     | \$ | 125,023        |
| Administrative expenses                       |    | (334)          |
| Income due participants, beginning of year    |    | <u>0</u>       |
| Income available for distribution             |    | 124,689        |
| Distribution                                  |    | <u>0</u>       |
| Income due participants, end of year (Note 2) | \$ | <u>124,689</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA REAL ESTATE POOL - NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Montana Real Estate Pool (MTRP pronounced "Mont Re") was approved by the Board on April 26, 2006, to permit the state's retirement systems to participate in a diversified real estate portfolio. Effective June 1, 2006, the nine retirement funds sold \$30,035,000 of their Short Term Investment Pool (STIP) investment to fund the new Montana Real Estate Pool (MTRP).

The Board approved the original Montana Real Estate Pool (MTRP) May 1998, to allow retirement and endowment funds, per section 17-6-201, MCA, the opportunity to participate in the Real Estate Investment Trust (REIT) equity market via a diversified pool. The original pool was created on July 1, 1998 by a spin-off of the REIT stock investments held in the Montana Stock Pool (MTCP). The MTCP participants received shares and an investment basis in the MTRP. Upon completion of the transaction, each MTCP/MTRP participant retained the same number of shares and investment basis originally held in the MTCP less the sale of fractional shares.

On March 1, 2001, the Board approved liquidation of the MTRP and all REIT securities were sold. Proceeds from the sale of securities were invested in the Short Term Investment Pool (STIP). In May 2001, the STIP investment was liquidated and the related STIP earnings were distributed to the MTRP participants as of June 1, 2001. As of June 30, 2001, all accounts related to the Montana Real Estate Pool reported a zero balance.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

MTRP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The MTRP will invest in external real estate managers with both open-end and closed-end pooled funds. Open-ended commingled funds will provide timely access to existing large funds with diversified property types, diversified geographic exposure to larger properties, and reasonable liquidity. The closed-end commingled fund investments may be made to obtain exposure to value and opportunistic investments. Reasonable due diligence is completed prior to selecting either type of investment.

The MTRP, as an internal investment pool, invests its excess cash in the Board's Short Term Investment Pool (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

Investments are presented in the statement of Net Asset Value based on the fair value of the portfolio.

Participant Units

The nine pension funds sold STIP shares totaling \$30,035,000 to fund the MTRP on June 1, 2006. Each pension fund participant was issued units in the new pool at an initial unit value of \$100. Unit values are calculated on the close of the last business day of the month, and based on the portfolio fair value. Based on the investment officer's decision, participants may buy or sell units on the first business day of each month.

Security Lending

Given the characteristics of the MTRP portfolio, MTRP will not participate in security lending.

3. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. STIP, as an external investment pool, has not been rated by a Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006, the MTRP investment in STIP was recorded in the name of the Montana Board of Investments.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. As of June 30, 2006, the MTRP's single investment is Montana's Short Term Investment Pool (STIP).

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. According to GASB Statement No. 40, "interest rate disclosures are not required for pooled investments if the pool is a 2a-7-like pool". Because STIP operates as a 2a-7 like pool, this exclusion applies to STIP.

### Specific Risk

Portfolio diversification of risk is achieved through multiple manager relationships and investments diversified by time, real estate type, real estate size, and geographical region. Real estate investments typically have a low correlation relative to other investment asset classes and contribute to the reduction of portfolio risk and the enhancement of expected returns on a total investment portfolio basis. Specific risks associated with MTRP are further described in the MTRP Investment Policy Statement.

## 4. REAL ESTATE MANAGER COMMITMENTS

The MTRP was created and funded on June 1, 2006 in anticipation of funding real estate manager capital calls prior to June 30, 2006. As of September 22, 2006 the Board has made commitments, but not yet funded, the following real estate managers:

| <u>Security Investment</u>       | <u>Original<br/>Commitment<br/>Date</u> | <u>Original<br/>Commitment</u> |
|----------------------------------|-----------------------------------------|--------------------------------|
| AG Core Plus Realty Fund II      | August 2006                             | 20,000,000                     |
| Apollo Real Estate Finance Corp. | September 2006                          | \$ 10,000,000                  |
| ABR Chesapeake III               | September 2006                          | 20,000,000                     |
| TA Associates Realty Fund VIII   | September 2006                          | <u>20,000,000</u>              |
| Total MTRP Commitments           |                                         | \$ <u>70,000,000</u>           |

## 5. YEAREND PORTFOLIO

The June 30, 2006 MTRP portfolio is listed below.

| <u>Security Name</u>       | <u>Coupon</u> | <u>Maturity</u> | <u>Shares</u>     | <u>Book Value</u> | <u>Fair Value</u> |
|----------------------------|---------------|-----------------|-------------------|-------------------|-------------------|
| SHORT TERM INVESTMENT POOL |               |                 | <u>30,159,689</u> | <u>30,159,689</u> | <u>30,159,689</u> |
| Cash Equivalents           |               |                 | <u>30,159,689</u> | <u>30,159,689</u> | <u>30,159,689</u> |
| MTRP Total                 |               |                 | <u>30,159,689</u> | <u>30,159,689</u> | <u>30,159,689</u> |



# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Private Equity Pool, as of June 30, 2006, and 2005, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Private Equity Pool, as of June 30, 2006, and 2005, and its changes in net asset value and investment income and distribution for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA PRIVATE EQUITY POOL FINANCIAL STATEMENTS

STATEMENT OF NET ASSET VALUE JUNE 30, 2006 AND 2005

|                                                                                                                      | <u>2006</u>           | <u>2005</u>           |
|----------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| <u>Assets</u>                                                                                                        |                       |                       |
| Cash                                                                                                                 | \$ 0                  | \$ 0                  |
| Dividend/interest receivable                                                                                         | 0                     | 28                    |
| Investments managed at fair value (carrying value of \$353,158,397 in 2006 and \$272,828,932 in 2005)(Notes 2 and 4) | <u>400,727,301</u>    | <u>297,638,172</u>    |
| Total assets                                                                                                         | \$ <u>400,727,301</u> | \$ <u>297,638,200</u> |
| <u>Liabilities</u>                                                                                                   |                       |                       |
| Income due participants                                                                                              | \$ <u>344,674</u>     | \$ <u>209,681</u>     |
| Total liabilities                                                                                                    | <u>344,674</u>        | <u>209,681</u>        |
| Net asset value                                                                                                      | \$ <u>400,382,627</u> | \$ <u>297,428,519</u> |
| Units Outstanding (Note 2)                                                                                           | 2,953,791             | 2,562,719             |
| Unit Value (Note 2)                                                                                                  | \$ 135.55             | \$ 116.06             |

STATEMENT OF CHANGES IN NET ASSET VALUE  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                                          |                       |                       |
|----------------------------------------------------------|-----------------------|-----------------------|
| Net asset value, beginning of year                       | \$ 297,428,519        | \$ 254,377,824        |
| Value of units purchased by participants (Notes 1 and 2) | 47,550,000            | 0                     |
| Value of units sold by participants                      | 0                     | 0                     |
| Changes in fair value of investments managed             | <u>55,404,108</u>     | <u>43,050,695</u>     |
| Net asset value, end of year                             | \$ <u>400,382,627</u> | \$ <u>297,428,519</u> |

STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                            |                   |                   |
|--------------------------------------------|-------------------|-------------------|
| Net realized gains (Note 2)                | \$ 2,000,000      | \$ 0              |
| Dividend/interest income                   | 4,840,414         | 2,846,253         |
| Administrative expenses (Note 2)           | (4,566,936)       | (3,734,605)       |
| Other expenses (Note 2)                    | (402,453)         | (67,925)          |
| Income due participants, beginning of year | <u>209,681</u>    | <u>5,273,616</u>  |
| Income available for distribution          | 2,080,706         | 4,317,339         |
| Distribution (Note 2)                      | <u>1,736,032</u>  | <u>4,107,658</u>  |
| Income due participants, end of year       | \$ <u>344,674</u> | \$ <u>209,681</u> |

STATE OF MONTANA BOARD OF INVESTMENTS  
MONTANA PRIVATE EQUITY POOL

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2006 AND 2005

1. HISTORY AND ORGANIZATION

The Board was created by the Legislature to invest and manage Montana's Unified Investment Program. The Montana Private Equity Pool (MPEP) was created by the Board to allow retirement funds, per section 17-6-201, MCA, the opportunity to participate in venture capital and leveraged buyout markets and other private equity investments via a diversified pool. The Board approved creation of the MPEP in April 2002. Effective May 1, 2002, the nine retirement funds transferred all their venture capital and leveraged buyout investments, at cost, totaling \$159,799,310, and cash of \$15,000,000 to the MPEP. These investments were previously reported in the All Other Funds financial statements.

Due to the complexity and specialization of private equity investment, the Board contracts with external private equity managers to invest in venture capital, leveraged buyout and other private equity investments. The eleven external managers as of June 30, 2006, by Board approval/commitment date, are:

|                                                  |                |
|--------------------------------------------------|----------------|
| Kohlberg, Kravis, Roberts and Company (KKR)      | August 1987    |
| Adams Street Partners, formerly Brinson Partners | January 1988   |
| Welsh Carson Anderson and Stowe                  | September 2000 |
| Madison Dearborn Partners                        | January 2001   |
| Lexington Partners                               | May 2001       |
| Oaktree Capital Management                       | September 2002 |
| ArcLight Energy Partners                         | April 2004     |
| Odyssey Investment Partners                      | December 2004  |
| Carlyle Partners                                 | January 2005   |
| Oak Hill Capital Partners                        | August 2005    |
| JLL Partners, Inc.                               | November 2005  |

In April 2005, the Board approved a staff recommendation that the "Board permanently delegate discretionary investment authority to Staff to negotiate and make binding commitments for MPEP private equity manager participation".

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

MPEP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The MPEP portfolio includes venture capital, leveraged buyout, mezzanine, distressed debt, special situation and secondary investments. Venture capital represents private equity investments in early stage financing of rapidly growing companies with an innovative product or service. Leveraged buyouts (LBO's) permit an investment group to acquire a company by leveraging debt, as a financing technique, to establish a significant ownership position on behalf of the company's current management team. Mezzanine investments are the subordinated debt and/or equity of privately owned companies. The debt holder participates in equity appreciation through conversion features, such as rights, warrants, and/or options. Distressed debt represents the private and public debt of companies that appear unlikely to meet their financial obligations. This debt is attractive to investors, not for repayment of interest and principal, which are unlikely to be paid, but for the claim placed on the firm's value by unpaid creditors. Without undue principal risk, distressed debt investment managers seek capital appreciation through the sale of restructured debt obligations or newly issued securities. Special situation investments include the investment in the exploration for oil and/or gas reserves or in the development of proven reserves, investment in land to harvest timber, and investments that have a special component usually related to geographical, economic, or social issues. Secondary investments are investments in previously owned limited partnerships. These investments may be direct or via a general partner specializing in secondary investments. Private equity investments are long-term, by design, and extremely illiquid.

MPEP cash is invested in an equity derivative, the State Street Stock Performance Index Futures Fund (SPIFF). Cash is swept daily into SPIFF so MPEP can maintain 100% equity exposure.

Investments are presented in the Statement of Net Asset Value at fair value. Because a recognized market does not exist for private equity investment, MPEP investments, on valuation date, are stated at the fair value reported in the most recent external managers' valuation reports. Carrying value, parenthetically disclosed, represents the private equity security purchase price.

#### Participant Units

The nine pension funds transferred all their venture capital and leveraged buyout investments, at cost, into the MPEP at the start-up date and were issued units according to the fair value of each participant's portfolio and cash contribution. The initial unit value as of May 1, 2002 was \$100. Although unit values are calculated at month end, the pool portfolio will be priced at least quarterly at the fair value reported in the external managers' valuation reports. Given the quarterly portfolio valuations, pool participant transactions will most likely occur on a quarterly basis. Based on the Investment Officer's decision, participants may buy, reinvest or sell units on the first business day of each month. All participant buys, reinvestments or sells occur after distribution of accumulated income.

#### Investment Income and Distribution

The Statement of Investment Income and Distribution reports cash dividends, interest, net realized gains and losses, and miscellaneous income. MPEP dividends are recorded on the ex-dividend date. Effective July 1, 2004, the MPEP net realized gains and losses are retained in the pool rather than distributed to the MPEP participants. This policy also allows realized gains to be used, if needed, to cover pool expenses. The fiscal year 2006 Investment Income includes the distribution of \$2 million of realized gains. The fiscal year 2005 Investment Income reflects only the distribution of ordinary income.

The MPEP Income Available for Distribution is distributed or reinvested, on behalf of the nine retirement fund participants as determined by the Investment Officer. Any cash distributions or reinvestments will occur on the first business day of the following month. The Income Available for Distribution is net of MPEP external manager fees and Board administrative expenses.

The fiscal year 2006 administrative expense of \$4,566,936 represents fees paid to the external managers of \$4,166,179 per their contracts and \$400,757 paid to the Board of Investments. The Board of Investments fee includes costs for the custodial bank contract. Administrative expenses incurred by the Board are charged daily to MPEP based on the Board's expenses applicable to MPEP.

The fiscal year 2005 administrative expense of \$3,734,605 represents fees paid to the external managers of \$3,498,261 per their contracts and \$236,344 paid to the Board of Investments. The Board of Investments fee includes costs for the custodial bank contract. Administrative expenses incurred by the Board are charged daily to MPEP based on the Board's expenses applicable to MPEP.

The fiscal year 2006 and 2005 other expenses represent interest paid in subscribing to new partnerships.

#### Security Lending

Because there is no active security lending market for this asset class, MPEP does not participate in security lending.

### **3. COMMITMENTS**

Private equity investments, typically, represent a seven to ten year commitment characterized by capital calls occurring during the first five years with distributions to the investor over the remaining term of the investment. The original and remaining commitments and their respective carrying and fair values, as of June 30, 2006, are listed on the next page.

| <u>Security Investment</u>                | <u>Original<br/>Commitment<br/>Date</u> | <u>Original<br/>Commitment</u> | <u>Commitment<br/>Remaining</u> | <u>Carrying<br/>Value</u> | <u>Fair<br/>Value</u> |
|-------------------------------------------|-----------------------------------------|--------------------------------|---------------------------------|---------------------------|-----------------------|
| Separate Account Partnerships             | Jan 1988-Apr 1990                       | \$ 13,618,000                  | \$ 25,000                       | \$ 1,454,321              | \$ 878,429            |
| Venture Partnership Acquisition Fund II   | April 1990                              | 4,000,000                      | 0                               | 190,080                   | 41,497                |
| Brinson Venture Capital/Partners Fund III | March 1992                              | 10,000,000                     | 0                               | 1,721,501                 | 2,052,743             |
| Brinson Venture Capital/Partners Fund III | October 1999                            | 10,000,000                     | 0                               | 2,028,790                 | 2,052,743             |
| Brinson Venture Capital Fund IV           | May 1999                                | 15,000,000                     | 891,667                         | 11,580,243                | 10,469,072            |
| Brinson Non-US Partnership Trust          | January 1999                            | 9,809,482                      | 1,785,689                       | 5,783,866                 | 7,984,824             |
| Brinson Partnership Trust 1996-2003       | March 1996                              | 103,319,781                    | 17,400,832                      | 68,290,738                | 73,292,830            |
| Adams Street Non-US Partnership Trust     | Aug 2001-Dec 2004                       | 16,000,000                     | 9,634,500                       | 5,741,358                 | 6,542,438             |
| Adams Street Partnership Fund             | Aug 2001-Dec 2004                       | 94,000,000                     | 61,323,000                      | 30,072,119                | 33,495,559            |
| Adams Street Partners Fund V              | August 2001                             | 40,000,000                     | 12,800,000                      | 24,913,712                | 22,756,035            |
| Adams Street Global Opportunities         | September 2003                          | 25,000,000                     | 20,812,500                      | 3,852,846                 | 4,475,316             |
| <b>Adams Street Total</b>                 |                                         | <b>340,747,263</b>             | <b>124,673,188</b>              | <b>155,629,574</b>        | <b>164,041,485</b>    |
| ArcLight Energy Partners Fund II          | April 2004                              | 25,000,000                     | 9,451,151                       | 14,168,812                | 14,526,815            |
| ArcLight Energy Partners Fund III         | November 2005                           | 25,000,000                     | 23,480,890                      | 1,368,496                 | 1,368,496             |
| <b>ArcLight Total</b>                     |                                         | <b>50,000,000</b>              | <b>32,932,041</b>               | <b>15,537,308</b>         | <b>15,895,311</b>     |
| Carlyle Partners Fund IV                  | January 2005                            | 35,000,000                     | 20,531,295                      | 14,315,672                | 14,395,986            |
| Carlyle Venture Partners Fund III         | April 2006                              | 25,000,000                     | 25,000,000                      | 0                         | 0                     |
| <b>Carlyle Partners Total</b>             |                                         | <b>60,000,000</b>              | <b>45,531,295</b>               | <b>14,315,672</b>         | <b>14,395,986</b>     |
| JLL Partners Fund V                       | November 2005                           | 25,000,000                     | 19,566,667                      | 3,052,490                 | 2,921,123             |
| <b>JLL Partners Total</b>                 |                                         | <b>25,000,000</b>              | <b>19,566,667</b>               | <b>3,052,490</b>          | <b>2,921,123</b>      |
| KKR 1986, 1987 Fund                       | August 1987                             | 25,300,000                     | 0                               | 2,021,493                 | 875,345               |
| KKR 1993 Fund                             | December 1990                           | 25,000,000                     | 0                               | 1,285,300                 | 332,571               |
| KKR 1996 Fund                             | July 1996                               | 100,000,000                    | 0                               | 35,414,941                | 29,422,804            |
| KKR European Fund                         | August 1999                             | 25,000,000                     | 0                               | 16,081,329                | 21,567,105            |
| <b>KKR Total</b>                          |                                         | <b>175,300,000</b>             | <b>0</b>                        | <b>54,803,063</b>         | <b>52,197,825</b>     |
| Lexington Capital Partners Fund V         | May 2001                                | 50,000,000                     | 7,135,505                       | 15,014,222                | 33,854,248            |
| Lexington Capital Partners Fund VI-B      | September 2005                          | 50,000,000                     | 48,068,159                      | 1,552,319                 | 1,512,105             |
| <b>Lexington Capital Partners Total</b>   |                                         | <b>100,000,000</b>             | <b>55,203,664</b>               | <b>16,566,541</b>         | <b>35,366,353</b>     |
| Madison Dearborn Partners Fund IV         | January 2001                            | 18,394,269                     | 2,385,747                       | 13,218,761                | 16,639,921            |
| Madison Dearborn Global Fund IV           | September 2002                          | 6,605,731                      | 1,550,910                       | 2,746,831                 | 7,151,593             |
| Madison Dearborn Partners Fund V          | May 2006                                | 25,000,000                     | 25,000,000                      | 0                         | 0                     |
| <b>Madison Dearborn Total</b>             |                                         | <b>50,000,000</b>              | <b>28,936,657</b>               | <b>15,965,591</b>         | <b>23,791,515</b>     |
| Oak Hill Capital Partners II              | August 2005                             | 21,656,022                     | 17,207,207                      | 3,920,199                 | 3,838,368             |
| Oak Hill Capital Partners II ( Cayman )   | August 2005                             | 3,343,978                      | 0                               | 3,343,978                 | 3,933,920             |
| <b>Oak Hill Capital Partners Total</b>    |                                         | <b>25,000,000</b>              | <b>17,207,207</b>               | <b>7,264,177</b>          | <b>7,772,288</b>      |
| Oaktree Capital Fund IVB                  | September 2002                          | 75,000,000                     | 0                               | 1                         | 5,907,856             |
| <b>Oaktree Total</b>                      |                                         | <b>75,000,000</b>              | <b>0</b>                        | <b>1</b>                  | <b>5,907,856</b>      |
| Odyssey Investment Partners Fund III      | December 2004                           | 25,000,000                     | 15,831,731                      | 8,414,360                 | 8,205,659             |
| <b>Odyssey Total</b>                      |                                         | <b>25,000,000</b>              | <b>15,831,731</b>               | <b>8,414,360</b>          | <b>8,205,659</b>      |
| Welsh Carson Anderson & Stowe Fund LX     | September 2000                          | 25,000,000                     | 1,750,000                       | 14,140,769                | 22,227,620            |
| WCAS Capital Partners Fund IV             | June 2004                               | 25,000,000                     | 13,750,000                      | 11,250,000                | 11,946,218            |
| WCAS X                                    | November 2005                           | 25,000,000                     | 19,750,000                      | 4,985,938                 | 5,014,567             |
| <b>Welsh Carson Total</b>                 |                                         | <b>75,000,000</b>              | <b>35,250,000</b>               | <b>30,376,707</b>         | <b>39,188,404</b>     |
| <b>Total Private Equity Commitments</b>   |                                         | <b>\$ 1,001,047,263</b>        | <b>\$ 375,132,450</b>           | <b>\$ 321,925,484</b>     | <b>\$ 369,683,805</b> |

#### 4. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

##### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, all MPEP investments were recorded in the name of the Montana Board of Investments. The State Street Bank repurchase agreement for \$447,174, as of June 30, 2005, was purchased in the State of

Montana Board of Investments name. This repurchase agreement was collateralized at \$458,263 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

#### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. Several MPEP investments represent limited partnership investments in various foreign countries. Per GASB Statement No. 40, no foreign currency risk disclosure is required for these limited partnership investments.

#### Specific Risk

Private equity investments are recognized as investments with a higher degree of risk with a higher return potential than traditional equity investments. Portfolio diversification of risk is achieved through multiple partnership relationships and investments diversified by time, financing stage, industry sector, investment size and geographical region. Private equity investments typically have a low correlation relative to other investment asset classes and contribute to the reduction of portfolio risk and the enhancement of expected returns on a total investment portfolio basis. Specific risks associated with MPEP are further described in the MPEP Investment Policy Statement.

### 5. INTERMOUNTAIN PRIVATE EQUITY PARTNERS

In October 2004, the Board committed \$25 million to Inter Mountain Private Equity Partners, LP, a regional venture capital "fund of funds" with Credit Suisse First Boston (CSFB), as the General Partner. This commitment was contingent upon CSFB raising an additional \$15 million from other investors in the region. Despite best efforts, the Fund dissolved May 2006 and the Board's commitment was withdrawn.

### 6. PRIVATE EQUITY COMMITMENT

On August 24, 2006, the Board funded the initial capital call in Carlyle Venture Fund III of \$4,402,470 which included investment and management fees.

In July 2006, the staff committed \$25 million to JC Flowers Sidecar Fund II, a buyout fund focused on the global financial services industry. On August 14, 2006, the Board made the initial investment of \$1,801,958.

In July 2006, the staff committed \$30 million to First Reserve Corp Fund XI, a buyout fund focused on the energy industry.

In August 2006, the staff committed \$35 million to Lehman Brothers Co-Investment Fund I and \$30 million to CCMP Capital Investors Fund II. Both managers invest in mid-market buyout funds.

### 7. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT download function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

### 8. YEAR END PORTFOLIO

The June 30, 2006 MPEP portfolio is listed below. The security type percentage is based on the fair value ratio of the specific security investment type to the total portfolio.

| <u>Security Name</u>           | <u>Par</u> | <u>Carrying Value</u> | <u>Fair Value</u> | <u>%</u> |
|--------------------------------|------------|-----------------------|-------------------|----------|
| ALTA SUB DEBT PARTNERS III     | 74,258     | 74,258                | 74,242            | 0.02%    |
| AUSTIN VENTURES III            | 235,584    | 235,584               | 194,032           | 0.05%    |
| CAPITAL PARTNERS HOLDINGS II A | 1          | 1                     | 465,745           | 0.12%    |

| <u>Security Name</u>                   | <u>Par</u>         | <u>Carrying Value</u> | <u>Fair Value</u>  | <u>%</u>      |
|----------------------------------------|--------------------|-----------------------|--------------------|---------------|
| MATRIX PARTNERS III L P                | 33,134             | 33,134                | 2,654              | 0.00%         |
| NEW ENTERPRISE ASSOC V LP              | 244,990            | 244,990               | 0                  | 0.00%         |
| O DONNELL + MASUR L P                  | 231,107            | 231,107               | 31,895             | 0.01%         |
| SPROUT CAPITAL VI                      | 244,756            | 244,756               | 6,725              | 0.00%         |
| SUMMIT VENTURE II                      | 128,881            | 128,881               | 1,739              | 0.00%         |
| WCAS CAPITAL PARTNERS II               | 261,611            | 261,611               | 101,397            | 0.03%         |
| SEPARATE PARTNERSHIPS                  | <b>1,454,321</b>   | <b>1,454,321</b>      | <b>878,429</b>     | <b>0.22%</b>  |
| VENTURE PARTNERSHIP ACQUIST            | 190,080            | 190,080               | 41,497             | 0.01%         |
| VENTURE PARTNER ACQUISITION II         | <b>190,080</b>     | <b>190,080</b>        | <b>41,497</b>      | <b>0.01%</b>  |
| BRINSON VENTURE CAPITAL III SECONDARY  | 82,168             | 82,168                | 251,374            | 0.06%         |
| BRINSON VENTURE PARTNERS III SECONDARY | 1,946,622          | 1,946,622             | 1,801,369          | 0.45%         |
| BRINSON VENTURE CAPITAL FUND III       | 71,872             | 71,872                | 251,374            | 0.06%         |
| BRINSON VENTURE PARTNER FUND III       | 1,649,629          | 1,649,629             | 1,801,368          | 0.45%         |
| INSTITUTIONAL VENTURE CAP FUND III     | <b>3,750,291</b>   | <b>3,750,291</b>      | <b>4,105,486</b>   | <b>1.02%</b>  |
| BRINSON VENTURE CAPITAL FUND IV        | 11,580,243         | 11,580,243            | 10,469,072         | 2.61%         |
| BRINSON VENTURE CAPITAL FUND IV        | <b>11,580,243</b>  | <b>11,580,243</b>     | <b>10,469,072</b>  | <b>2.61%</b>  |
| BRINSON NON US PARTNERSHIP FUND        | 5,783,866          | 5,783,866             | 7,984,824          | 1.99%         |
| BRINSON PARTNERSHIP FUND TRUST         | 68,290,738         | 68,290,738            | 73,292,830         | 18.29%        |
| BRINSON PARTNERSHIP TRUST              | <b>74,074,604</b>  | <b>74,074,604</b>     | <b>81,277,653</b>  | <b>20.28%</b> |
| ADAMS NON US PARTNERSHIP FUND          | 5,741,358          | 5,741,358             | 6,542,438          | 1.63%         |
| ADAMS STREET PARTNERSHIP FUND          | 30,072,119         | 30,072,119            | 33,495,559         | 8.36%         |
| ADAMS STREET PARTNERS TRUST            | <b>35,813,477</b>  | <b>35,813,477</b>     | <b>40,037,997</b>  | <b>9.99%</b>  |
| ADAMS STREET FUND V                    | 24,913,712         | 24,913,712            | 22,756,035         | 5.68%         |
| ADAMS STREET FUND V                    | <b>24,913,712</b>  | <b>24,913,712</b>     | <b>22,756,035</b>  | <b>5.68%</b>  |
| ADAMS STREET GLOBAL OPPORTUNITES       | 3,852,846          | 3,852,846             | 4,475,316          | 1.12%         |
| ADAMS STREET GLOBAL OPPORTUNITES       | <b>3,852,846</b>   | <b>3,852,846</b>      | <b>4,475,316</b>   | <b>1.12%</b>  |
| <b>ADAMS STREET TOTAL</b>              | <b>155,629,574</b> | <b>155,629,574</b>    | <b>164,041,485</b> | <b>40.94%</b> |
| ARCLIGHT ENERGY PARTNERS FD II         | 14,168,812         | 14,168,812            | 14,526,815         | 3.63%         |
| ARCLIGHT ENERGY PARTNERS FD III        | 1,368,496          | 1,368,496             | 1,368,496          | 0.34%         |
| <b>ARCLIGHT CAPITAL TOTAL</b>          | <b>15,537,308</b>  | <b>15,537,308</b>     | <b>15,895,311</b>  | <b>3.97%</b>  |
| CARLYLE PARTNERS IV, L.P.              | 11,003,388         | 11,003,388            | 11,083,702         | 2.77%         |
| CARLYLE PARTNERS IV CAYMAN             | 3,312,284          | 3,312,284             | 3,312,284          | 0.83%         |
| <b>CARLYLE GROUP TOTAL</b>             | <b>14,315,672</b>  | <b>14,315,672</b>     | <b>14,395,986</b>  | <b>3.59%</b>  |
| JLL PARTNERS FUND V LP                 | 3,052,490          | 3,052,490             | 2,921,123          | 0.73%         |
| <b>JLL PARTNERS TOTAL</b>              | <b>3,052,490</b>   | <b>3,052,490</b>      | <b>2,921,123</b>   | <b>0.73%</b>  |
| KKR 1986 1987                          | 2,021,493          | 2,021,493             | 875,345            | 0.22%         |
| KKR 1993                               | 1,285,300          | 1,285,300             | 332,571            | 0.08%         |
| KKR 1996                               | 35,414,941         | 35,414,941            | 29,422,804         | 7.34%         |
| KKR EUROPEAN FUND                      | 16,081,329         | 16,081,329            | 21,567,105         | 5.38%         |
| <b>KKR TOTAL</b>                       | <b>54,803,063</b>  | <b>54,803,063</b>     | <b>52,197,825</b>  | <b>13.03%</b> |
| LEXINGTON CAPITAL PARTNERS VIB         | 1,552,319          | 1,552,319             | 1,512,105          | 0.38%         |
| LEXINGTON CAPITAL PARTNERSHIP V        | 15,014,222         | 15,014,222            | 33,854,248         | 8.45%         |
| <b>LEXINGTON CAPITAL TOTAL</b>         | <b>16,566,541</b>  | <b>16,566,541</b>     | <b>35,366,353</b>  | <b>8.83%</b>  |
| MADISON DEARBORN CAPITAL PARTNERS IV   | 13,218,761         | 13,218,761            | 16,639,921         | 4.15%         |
| MDP IV GLOBAL INVESTMENTS LP           | 2,746,831          | 2,746,831             | 7,151,593          | 1.78%         |
| <b>MADISON DEARBORN TOTAL</b>          | <b>15,965,591</b>  | <b>15,965,591</b>     | <b>23,791,515</b>  | <b>5.94%</b>  |
| OAK HILL CAPITAL PARTNERS II           | 3,920,199          | 3,920,199             | 3,838,368          | 0.96%         |
| OAK HILL CP II (CAYMAN)                | 3,343,978          | 3,343,978             | 3,933,920          | 0.98%         |
| <b>OAK HILL CAPITAL TOTAL</b>          | <b>7,264,177</b>   | <b>7,264,177</b>      | <b>7,772,288</b>   | <b>1.94%</b>  |

| <u>Security Name</u>                 | <u>Par</u>         | <u>Carrying Value</u> | <u>Fair Value</u>  | <u>%</u>       |
|--------------------------------------|--------------------|-----------------------|--------------------|----------------|
| OCM OPPORTUNITIES FUND IVB LP        | 1                  | 1                     | 5,907,856          | 1.47%          |
| <b>OAKTREE CAPITAL TOTAL</b>         | <b>1</b>           | <b>1</b>              | <b>5,907,856</b>   | <b>1.47%</b>   |
| ODYSSEY INVESTMENT PARTNERS FUND III | 8,414,360          | 8,414,360             | 8,205,659          | 2.05%          |
| <b>ODYSSEY PARTNERS TOTAL</b>        | <b>8,414,360</b>   | <b>8,414,360</b>      | <b>8,205,659</b>   | <b>2.05%</b>   |
| WCAS CAPITAL PARTNERS FUND IV        | 11,250,000         | 11,250,000            | 11,946,218         | 2.98%          |
| WCAS IX                              | 14,140,769         | 14,140,769            | 22,227,620         | 5.55%          |
| WCAS X LP                            | 4,985,938          | 4,985,938             | 5,014,567          | 1.25%          |
| <b>WCAS TOTAL</b>                    | <b>30,376,707</b>  | <b>30,376,707</b>     | <b>39,188,404</b>  | <b>9.78%</b>   |
| <b>TOTAL PRIVATE EQUITIES</b>        | <b>321,925,484</b> | <b>321,925,484</b>    | <b>369,683,805</b> | <b>92.25%</b>  |
| STATE STREET SPIFF                   | 184,326            | 31,232,912            | 31,043,496         | 7.75%          |
| <b>STATE STREET TOTAL</b>            | <b>184,326</b>     | <b>31,232,912</b>     | <b>31,043,496</b>  | <b>7.75%</b>   |
| <b>MPEP TOTAL</b>                    | <b>322,109,810</b> | <b>353,158,397</b>    | <b>400,727,301</b> | <b>100.00%</b> |



# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Investments Managed for the state of Montana Board of Investments, All Other Funds, as of June 30, 2006, and 2005, and the related Statement of Net Investment Income and Statement of Changes in Net Investments Managed for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net investments managed by the Montana Board of Investments, All Other Funds, as of June 30, 2006, and 2005, and its net investment income and changes in its net investments managed for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS  
ALL OTHER FUNDS FINANCIAL STATEMENTS

STATEMENT OF NET INVESTMENTS MANAGED, JUNE 30, 2006 AND 2005

|                                                                                                                                     | <u>2006</u>             | <u>2005</u>             |
|-------------------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| <u>Assets</u>                                                                                                                       |                         |                         |
| Investments managed at fair value<br>(amortized cost of \$1,482,517,445 in 2006 and<br>\$1,455,078,161 in 2005) (Notes 2, 6 and 13) | \$ 1,476,243,872        | \$ 1,477,780,667        |
| Security lending cash collateral (Notes 3 and 6)                                                                                    | 372,705,511             | 200,025,086             |
| Interest receivable                                                                                                                 | 15,409,976              | 14,147,103              |
| Broker receivable for securities sold but not settled<br>(Note 2)                                                                   | <u>127,807</u>          | <u>150,249</u>          |
| Total assets                                                                                                                        | \$ <u>1,864,487,166</u> | \$ <u>1,692,103,105</u> |
| <u>Liabilities</u>                                                                                                                  |                         |                         |
| Unrealized gain (loss)                                                                                                              | \$ (6,273,573)          | \$ 22,702,506           |
| Security lending obligations                                                                                                        | 372,705,511             | 200,025,086             |
| Security lending expense payable                                                                                                    | 811,666                 | 468,041                 |
| Broker payable for securities purchased but not settled<br>(Note 2)                                                                 | 0                       | 7,000,000               |
| Accounts payable                                                                                                                    | <u>31,996</u>           | <u>10,628</u>           |
| Total liabilities                                                                                                                   | \$ <u>367,275,600</u>   | \$ <u>230,206,261</u>   |
| Net investments managed                                                                                                             | \$ <u>1,497,211,566</u> | \$ <u>1,461,896,844</u> |

STATEMENT OF NET INVESTMENT INCOME  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                      |                       |                      |
|--------------------------------------|-----------------------|----------------------|
| <u>Income</u>                        |                       |                      |
| Investment income (Note 2)           | \$ 68,598,183         | \$ 67,036,824        |
| Realized gain/loss on sales (Note 2) | 41,367,058            | 14,582,969           |
| Amortization/accretion               | 1,011,473             | (686,441)            |
| Security lending income              | <u>9,457,635</u>      | <u>4,905,282</u>     |
| Total income                         | \$ <u>120,434,349</u> | \$ <u>85,838,634</u> |
| <u>Expenses</u>                      |                       |                      |
| Administrative expenses              | 929,648               | 1,041,912            |
| Security lending expense             | <u>9,308,384</u>      | <u>4,707,900</u>     |
| Total expenses                       | \$ <u>10,238,032</u>  | \$ <u>5,749,812</u>  |
| Net investment income                | \$ <u>110,196,317</u> | \$ <u>80,088,822</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
ALL OTHER FUNDS FINANCIAL STATEMENTS

STATEMENT OF CHANGES IN NET INVESTMENTS MANAGED  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

|                                                                                                       | <u>2006</u>             | <u>2005</u>             |
|-------------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| Total net investments managed, beginning of year                                                      | \$ 1,461,896,844        | \$ 1,338,199,509        |
| Net investment income                                                                                 | 110,196,317             | 80,088,822              |
| Income remitted to agencies                                                                           | <u>111,459,190</u>      | <u>80,311,768</u>       |
| Increase (decrease) in interest receivable                                                            | 1,262,873               | 222,946                 |
| Increase (decrease) in broker receivable (Note 2)                                                     | (22,442)                | (234,728)               |
| Increase (decrease) in security lending cash collateral<br>(Notes 3 and 6)                            | 172,680,425             | (26,674,762)            |
| Investments purchased                                                                                 | 5,512,694,333           | 2,935,049,627           |
| Investments sold, matured and called                                                                  | <u>(5,486,266,522)</u>  | <u>(2,803,372,615)</u>  |
| Increase (decrease) in book value of investments                                                      | 26,427,811              | 131,677,012             |
| Increase (decrease) in book value of investments due to<br>net amortization of discounts and premiums | 1,011,473               | (686,441)               |
| (Increase) decrease in broker payable (Note 2)                                                        | , 7,000,000             | (7,000,000)             |
| (Increase) decrease in accounts payable                                                               | (21,368)                | (341)                   |
| (Increase) decrease in security lending obligations<br>(Notes 3 and 6)                                | (172,680,425)           | 26,674,762              |
| (Increase) decrease in security lending expense payable                                               | <u>(343,625)</u>        | <u>(281,113)</u>        |
| Net investments managed, end of year                                                                  | \$ <u>1,497,211,566</u> | \$ <u>1,461,896,844</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS  
ALL OTHER FUNDS  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2006 AND 2005

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis per section 17-6-201, MCA. The All Other Funds (AOF) investments and income are owned by various State of Montana agencies and managed on their behalf by the Board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

The AOF investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle" and applicable investment restrictions of the participants. The AOF portfolio includes securities classified as corporate, U.S. government direct-backed, U.S. government indirect-backed, equity index, real estate, mortgages and loans. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages. Equity index investments are investments in selected mutual funds whose equity portfolios match a broad based index or composite.

AOF fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. As of June 30, 2006, the AOF portfolio held two variable rate corporate bonds with an amortized cost of \$14 million. As of June 30, 2005, the AOF portfolio held one variable rate corporate bond with an amortized cost of \$4 million. The AOF variable-rate securities float with LIBOR (London Interbank Offered Rate), a residual component or the weighted average of the net mortgage interest rates for the mortgage loan group. (See Note 13 for the Year End Portfolio.)

Investments are presented in the Statement of Net Investments Managed at fair value. Fair values for publicly traded securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank and Trust. The real estate investments and residential and multi-family mortgages are valued based on a discounted cash flow. The commercial in-state coal tax loans and the nonparticipating repurchase agreements are reported at amortized cost. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

Broker Receivable/Payable

AOF security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the AOF portfolio at June 30 may include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

Montana Mortgages and Loans Receivable

The Montana mortgages and loans receivable, included in the Statement of Net Investments Managed, represent residential mortgages and multifamily commercial loans funded by the Public Employees' and Teachers' pension funds and other loans funded by the Coal Severance Tax Trust fund. In November and December 2004, the multifamily commercial loans held by the Public Employees' and Teachers' pension funds totaling \$3,334,969 were sold to the Coal Severance Tax Trust Fund. The Coal Severance Tax Trust loan portfolio includes loans made by the Montana Science and Technology Alliance (MSTA) Board. The MSTTA Board was abolished on July 1, 1999 and by law, the MSTTA portfolio was assigned to the Board of Investments. (See Note 7 for the Montana mortgages and loans portfolio).

In June 2005, the Board received notice that Positive Systems, Inc. has "ceased business operations". This borrower, funded by the MSTTA, received \$200,000 and \$350,000 in May 1994 and March 1998, respectively. As of June 30, 2006 and 2005, Positive Systems, Inc. had an outstanding loan balance of \$546,074. In July 2006, the Board received confirmation that Positive Systems, Inc. has "indeed ceased all business operation". This loan balance of \$546,074 was written off in September 2006. With the exception of this loan, there were no other uncollectible account balances for Montana mortgages and loans receivable as of June 30, 2006 and 2005. In February 2005, the Board charged off \$147,156 in principal for Safe ShopTools, Inc. The MSTTA funded a total of \$162,500 to Safe ShopTools, Inc. in February 1997 and June 1999.

In March 2005, the Monthly Mortgage Accounting Process related to remittances, payoffs and billing was transferred to the Montana Board of Housing accounting staff.

### Investment Income

Investment income reported in the Statement of Net Investment Income includes fixed income and mortgage interest earnings, real estate income, commercial loan interest earnings and commitment fees.

### Realized Gain on Sales

Realized gain on sales reported in the Statement of Net Investment Income represents the net gain/loss resulting from the sale of fixed income, private equity and pool investments. In fiscal year 2006, the sale of pool units from the Montana Domestic Equity Pool (MDEP), Trust Funds Bond Pool (TFBP), and the Montana International Equity Pool (MTIP) generated a net gain to participants of \$42,974,810. In fiscal year 2005, the sale of pool units from the Montana Domestic Equity Pool (MDEP) and the Trust Funds Bond Pool (TFBP), generated a net gain to participants of \$13,609,808.

## 3. SECURITIES LENDING

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 102 percent of the fair value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street Bank loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street Bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street Bank.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively, as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

As of June 30, 2006, the carrying and fair value of the underlying securities on loan for the All Other Funds was \$201,367,407 and \$198,856,122, respectively. The collateral provided for the securities on loan totaled \$372,705,511 in cash and \$6,215,625 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$13,922,060 corporate, \$27,403,678 U.S. government direct-backed and \$160,041,669 U.S. government indirect-backed.

As of June 30, 2005, the carrying and fair value of the underlying securities on loan for the All Other Funds was \$213,820,105 and \$217,153,315, respectively. The collateral provided for the securities on loan totaled \$200,025,086 in cash and \$23,616,389 in securities collateral. The carrying value of the underlying securities on loan is categorized as \$31,693,857 corporate, \$30,489,301 U.S. government direct-backed and \$151,636,947 U.S. government indirect-backed.

## 4. COAL TAX LOAN AND MORTGAGE COMMITMENTS

The Board makes firm commitments to fund loans from the Coal Severance Tax Trust fund. These commitments have expiration dates and may be extended according to the Board's policies. As of June 30, 2006, the Board had committed but not yet purchased \$76,503,977 in loans from Montana lenders, compared to \$78,813,735 as of June 30, 2005. In addition to the above commitments, lenders had reserved \$55,143,007 for loans as of June 30, 2006, compared to \$28,884,945 on the same date in 2005.

The Board makes reservations to fund mortgages from the Public Employees' and Teachers' retirement funds. As of June 30, 2006, mortgage reservations totaled \$1,478,884. Effective December 1, 2005, all Board residential mortgage purchases are processed by the Montana Board of Housing (MBOH). The MBOH does not differentiate between a mortgage reservation and a funding commitment. As of June 30, 2005, the Board had committed but not yet purchased from Montana lenders mortgages totaling \$2,145,343. Mortgage reservations totaled \$1,683,900 as of June 30, 2005.

## 5. PENSION FUND REAL ESTATE INVESTMENTS

### 100 North Park Building

In January 1996, the Board, on behalf of the Public Employees' and Teachers' Retirement funds, purchased the 100 North Park Avenue Building in Helena, Montana as a real estate investment. Acquired for a cost of \$4,864,326, the building carries a fair value of \$6,141,593 as of June 30, 2006. During fiscal year 2006, building improvements for tenant remodeling, heating/cooling, and leasing fees totaling \$64,607 were added to the cost of the building. Building improvements and leasing fees totaling \$151,567 were included in the cost of the building in fiscal year 2005. The three-story building provides office space for approximately eight to ten tenants.

### 2401 Colonial Drive Building

In August 1997, the Board authorized the construction of an office building, as a real estate investment owned equally by the Public Employees' and Teachers' Retirement funds. Construction costs, including interest capitalization, totaled \$6,481,741 as of June 30, 2000. In fiscal year 2006, heating/cooling system improvements and leasing fees of \$93,257 were added to the building cost. For fiscal year 2005, \$48,838 was expended on parking lot resurfacing and heating/cooling system improvements. The three-story building, providing office space for three tenants, was occupied in November 1999. As of June 30, 2006, the building carries a cost and fair value of \$7,183,851 and \$7,676,250, respectively.

### 2273 Boot Hill Court Building

In August 1999, the Board authorized the purchase of a new office building in Bozeman, Montana. Upon construction completion, the Public Employees' and Teachers' Retirement funds purchased the building, in March 2004, as a real estate investment with equal ownership, for \$2,051,032. In fiscal year 2006, there were no improvements made to this building. In fiscal year 2005, telecommunication system payments were added to the building cost of \$10,238. The building, located on state school trust land, is occupied by four state agencies. As of June 30, 2006, the building carries a fair value of \$2,082,014.

### 1712 Ninth Avenue Building

In November 2000, the Board reviewed the transfer of the Public Employees' Retirement Administration (PERA) office building, located at 1712 Ninth Avenue, Helena, to the Board of Investments. By issuance of a corrective deed, the Board of Investments was named owner and building manager for the use and benefit of the PERA. In fiscal year 2006, installations were made for door operators totaling \$3,257. During fiscal year 2005, fire alarm system upgrades and parking lot improvements totaling \$12,600 were added to the building cost. As of June 30, 2006, the building, occupied by one tenant, is valued at \$579,626.

The schedule below details the minimum future rentals for the above buildings with non-cancelable operating leases as of June 30, 2006 and 2005:

#### Minimum future rentals for the year ending June 30, 2006:

| <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012+</u> | <u>Total</u> |
|-------------|-------------|-------------|-------------|-------------|--------------|--------------|
| \$833,146   | \$432,518   | \$435,122   | \$439,993   | \$413,109   | \$477,931    | \$3,031,819  |

#### Minimum future rentals for the year ending June 30, 2005:

| <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011+</u> | <u>Total</u> |
|-------------|-------------|-------------|-------------|-------------|--------------|--------------|
| \$705,654   | \$404,496   | \$295,823   | \$243,861   | \$248,732   | \$731,656    | \$2,630,222  |

### California Street Property

In December 1998, the Board acquired a parcel of land adjacent to the Colonial Drive building to provide for additional parking. This land was purchased for \$204,835. As of June 30, 2006 the property carries a fair value of \$213,603.

## 6. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

### Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the AOF fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires AOF fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's and Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the following table are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, all the fixed income and other equity securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank, State Street Bank. The Equity Index, Real Estate, Mortgage and Loan investments are registered in the name of the Montana Board of Investments. The State Street and US Bank repurchase agreements were purchased in the State of Montana Board of Investments name.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. With the exception of one fund, the 20 remaining investment policy statements for various state agencies do not address concentration of credit risk. One fund requires credit risk to be limited to 3 percent in any one name except AAA rated issues will be limited to 6%. This fund also has specific client preferences. Investments issued or explicitly guaranteed by the U.S. government and investments by various state agencies, pooled as the All Other Funds, are excluded from the concentration of credit risk requirement.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The All Other Funds' investment policies do not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs and ARMs)."

As of June 30, 2006 and 2005, the AOF portfolio did not hold any structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. The REMIC securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2006 and June 30, 2005. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

**Credit Quality Rating and Effective Duration as of June 30, 2006**

| <u>Security Investment Type</u>               |           | <u>Fair Value</u>           | <u>Credit Quality Rating</u> | <u>Effective Duration</u> |
|-----------------------------------------------|-----------|-----------------------------|------------------------------|---------------------------|
| Corporate Bonds (Rated)                       | \$        | 386,073,420                 | A                            | 3.69                      |
| U.S. Government Direct-Backed                 |           | 62,682,844                  | AAA                          | 4.55                      |
| U.S. Government Indirect-Backed               |           | 620,036,700                 | AAA                          | 2.39                      |
| US Bank Sweep Repurchase Agreement*           |           | <u>18,642,905</u>           | <u>NR</u>                    | <u>NA</u>                 |
| Total Fixed Income Investments                | \$        | <u>1,087,435,869</u>        | <u>AA</u>                    | <u>2.99</u>               |
| <u>Direct Investments</u>                     |           |                             |                              |                           |
| Equity Index Fund                             | \$        | 83,377,362                  |                              |                           |
| Real Estate                                   |           | 16,693,086                  |                              |                           |
| MT Mortgages and Loans                        |           | <u>288,737,555</u>          |                              |                           |
| Total Direct Investments                      | \$        | <u>388,808,003</u>          |                              |                           |
| <b>TOTAL INVESTMENTS</b>                      | <b>\$</b> | <b><u>1,476,243,872</u></b> |                              |                           |
| Securities Lending Collateral Investment Pool | \$        | <u>372,705,511</u>          | NR                           | NA                        |

\*At June 30, 2006, the US Bank repurchase agreement, per contract, was collateralized at 102% for \$19,024,084 by a Federal Home Loan Mortgage Corporation REMIC maturing July 15, 2033. This security carries a AAA credit quality rating.

**Credit Quality Rating and Effective Duration as of June 30, 2005**

| <u>Security Investment Type</u>               |           | <u>Fair Value</u>           | <u>Credit Quality Rating</u> | <u>Effective Duration</u> |
|-----------------------------------------------|-----------|-----------------------------|------------------------------|---------------------------|
| Corporate Bonds (Rated)                       | \$        | 344,153,594                 | A                            | 3.83                      |
| U.S. Government Direct-Backed                 |           | 72,631,014                  | AAA                          | 3.35                      |
| U.S. Government Indirect-Backed*              |           | 634,726,860                 | AAA                          | 2.25                      |
| State Street Repurchase Agreement** (Rated)   |           | 10,350,520                  | AA-                          | NA                        |
| US Bank Sweep Repurchase Agreement***         |           | <u>16,542,234</u>           | <u>NR</u>                    | <u>NA</u>                 |
| Total Fixed Income Investments *              | \$        | <u>1,078,404,222</u>        | <u>AA</u>                    | <u>2.84</u>               |
| <u>Direct Investments</u>                     |           |                             |                              |                           |
| Equity Index Fund                             | \$        | 76,737,097                  |                              |                           |
| Equity Other                                  |           | 140                         |                              |                           |
| Real Estate                                   |           | 16,474,430                  |                              |                           |
| MT Mortgages and Loans                        |           | <u>306,164,778</u>          |                              |                           |
| Total Direct Investments                      | \$        | <u>399,376,445</u>          |                              |                           |
| <b>TOTAL INVESTMENTS</b>                      | <b>\$</b> | <b><u>1,477,780,667</u></b> |                              |                           |
| Securities Lending Collateral Investment Pool | \$        | <u>200,025,086</u>          | NR                           | NA                        |

\* The U.S. Government Indirect-Backed Effective Duration changed from 2.74 to 2.25 due to correction of an error. This change resulted in the revision of the Effective Duration for the Total Fixed Income Investments from 2.99 to 2.84.

\*\* At June 30, 2005, the State Street Bank repurchase agreement was collateralized at \$10,607,177 by a AAA rated Federal Home Loan Mortgage Corporation note maturing February 15, 2006.

\*\*\*At June 30, 2005, the US Bank repurchase agreement, per contract, was collateralized at 102% for \$16,874,485 by Federal Home Loan Mortgage Corporation REMICs maturing September 15, 2032 and November 15, 2033. These securities carry a AAA credit quality rating.

## Specific Legal and Credit Risk

As of June 30, 2005, Delta Airlines Corp. presented a higher credit risk to the Board. The AOF portfolio held a \$10 million par 6.417% Delta Airlines Corp. bond maturing July 2, 2012. The book value of this security was \$9,968,673 as of June 30, 2005. This issue was insured by MBIA Insurance Corp. to support the payment of any interest due and outstanding principal balance. Delta Airlines Corp. filed for Chapter 11 bankruptcy protection on September 14, 2005. Since this issue was insured, the Board did not stop the interest income accrual or reduce the book value. In April 2006, the outstanding principal and interest of \$10,187,163 for this security was paid by the MBIA Insurance Corp. The Board recorded a gain of \$27,677 on this transaction.

As of June 30, 2005, Northwest Airlines Inc. presented a higher credit risk to the Board. The AOF portfolio held a \$4,137,515 par 6.81% Northwest Airlines Inc. bond maturing February 1, 2020. The book value of this security was \$4,084,548 as of June 30, 2005. Due to the company's filing for Chapter 11 bankruptcy protection on September 14, 2005, the Board stopped the interest income accruals after the August 2005 pay date. This issue was sold on September 20, 2005 generating a loss of \$358,311. The sale included accrued interest from August 1, 2005 to September 20, 2005.

### 7. MONTANA MORTGAGES AND LOANS

The Montana mortgages and loans portfolio is shown below.

| <u>Montana Mortgages and Loans</u>             | <u>2006<br/>Book Value</u> | <u>2005<br/>Book Value</u> |
|------------------------------------------------|----------------------------|----------------------------|
| Residential Mortgages                          | 80,750,504                 | 92,939,453                 |
| Science and Technology Alliance <sup>(1)</sup> | 4,985,147                  | 5,046,515                  |
| Montana University System <sup>(1)</sup>       | 8,880,585                  | 8,956,895                  |
| Department of Natural Resources <sup>(2)</sup> | 31,047,064                 | 41,896,024                 |
| Department of Justice                          | 2,112,000                  | 2,112,000                  |
| Montana Facility Finance                       | 14,476                     | 47,482                     |
| Local Government Infrastructure                | 7,465,725                  | 5,659,452                  |
| Value-added Loans                              | 9,191,738                  | 11,104,003                 |
| Commercial Loans                               | <u>145,231,919</u>         | <u>137,531,210</u>         |
| Permanent Coal Trust Loans                     | 208,928,654                | 212,353,581                |
| Total Montana Mortgages and Loans              | \$ <u>289,679,158</u>      | \$ <u>305,293,034</u>      |

(1) The Montana Science and Technology Alliance (MSTA) loans include funding for research and development, mezzanine and seed capital loans. The Commercial Loan total, as previously reported of \$146,488,105 as of June 30, 2005, included \$8,956,895 in loans to the Montana University System. This total has been restated as \$137,531,210 to separately report the total loans to the Montana University System.

(2) In accordance with Senate Bill 495 enacted by the 2001 Legislature, the Coal Severance Tax Permanent Trust loaned 483,604 TFBP shares, with a book value of \$46,366,904, to the Department of Natural Resources, Trust and Legacy fund on July 2, 2001. The loan proceeds were deposited in the Trust and Legacy Fund. A loan receivable was recorded in the Coal Severance Tax Permanent Trust and a corresponding liability was recorded in the Guarantee Fund, a General Fund sub-fund. The August 2002 Special Legislative Session approved the request to record this activity in a state special revenue fund of the Office of Public Instruction rather than in the Guarantee Fund. In fiscal year 2006, the Trust and Legacy Fund paid \$10,848,960 to the Coal Severance Tax Permanent Trust. These transactions reduced the TFBP shares on loan to 323,819 with a corresponding book value of \$31,047,064. During fiscal year 2005, the Trust and Legacy Fund paid \$2,650,063 to the Coal Severance Tax Permanent Trust reducing the TFBP shares on loan to 436,973 with a corresponding book value of \$41,896,024.

### 8. DEUTSCHE BANK SECURITIES, INC. COMPLAINT

The Board received a summons and complaint, dated September 3, 2002, regarding the sale of a Pennzoil Quaker State, \$2 million par, 6.75% corporate bond maturing April 1, 2009. Deutsche Bank Securities claims a "breach of contract" for the March 25, 2002 sale of the bond at a price of \$94.669 plus accrued interest. Deutsche Bank Securities seeks damages of \$215,453 for the additional costs incurred to acquire the bond from third parties, plus any statutory interest, costs and expenses. On October 1, 2002, Shell Oil Company acquired Pennzoil and subsequently announced a public tender of Pennzoil Quaker State debt. The Board tendered the Pennzoil Quaker State holdings on October 8, 2002 at a price of

\$113,099. The tender was accepted with a settlement date of November 1, 2002. On November 4, 2002, the Board received \$2,273,230 in principal and interest plus \$60,000 as a consent fee.

On December 11, 2003, the Supreme Court of the State of New York, New York County, entered an order dismissing Deutsche Bank's complaint on jurisdictional grounds. Deutsche Bank appealed that decision to the Appellate Division, which on June 14, 2005 reversed the Supreme Court and entered an order determining the Board to be liable and remanding the matter back to the Supreme Court for a determination of damages. The Board appealed that decision to the New York Court of Appeals, which on June 6, 2006 affirmed the Appellate Division's decision. The Board has since petitioned for certiorari to the United States Supreme Court on certain jurisdictional issues. At the same time, discovery is proceeding in the New York Supreme Court to determine damages.

#### 9. LOAN GUARANTEES

As of June 30, 2006, loan guarantees provided by the Coal Severance Tax Permanent Trust to the Enterprise Fund and the Montana Facility Finance Authority total \$131,280,309. Board of Investment exposure to bond issues of the Enterprise Fund is \$84,050,000 while exposure to bond issues, surety bonds and designated loans of the Facility Finance Authority is \$47,230,309.

As of June 30, 2005, loan guarantees provided by the Coal Severance Tax Permanent Trust to the Enterprise Fund and the Montana Facility Finance Authority total \$130,476,641. Board of Investment exposure to bond issues of the Enterprise Fund is \$85,160,000 while exposure to bond issues, surety bonds and designated loans of the Facility Finance Authority is \$45,316,641.

#### 10. BLOOMBERG PORTFOLIO ORDER MANAGEMENT SYSTEM (POMS)

In July 2005, the Board agreed to lease a Portfolio Order Management System (POMS) from Bloomberg Financial Services. This electronic securities trading system reduces trading time and paperwork, increases trading and accounting accuracy, and provides certain controls not previously available. The Board has been using the basic Bloomberg Financial Network Services for many years and already leased the hardware required to implement the trading system.

Electronic trading began with the internally-managed component of the Montana Domestic Equity Pool in August 2005. Implementation of electronic trading for the Short Term Investment Pool and the other fixed income portfolios, as managed by Board Staff, was completed in fiscal year 2006.

#### 11. CLASS ACTION LITIGATION

In April 2005, the Board signed a contract with the law firm Barrack, Rodos & Bacine to ensure that the Board participates in all class action litigation to which it is entitled to participate. Historically, the Board, by agreement with its custodial bank, State Street Bank, has relied on State Street staff to complete and file class action claims on the Board's behalf.

While State Street Bank will continue to complete these duties, the law firm will monitor transactions that may entitle the Board to be a party in any class action litigation. The law firm will access Board portfolios and securities transactions on the State Street accounting system using the INSIGHT download function. The law firm will then request written documentation from the Bank proving the claims have been filed.

Class action litigation results from fraudulent activity damaging the Board's investments. While the Board has never pursued becoming a lead plaintiff in class action litigation, the law firm contract permits the Board to become a lead or co-lead plaintiff in these instances. Under certain circumstances the Board's fiduciary responsibility may require it to act as a lead or co-lead plaintiff to recover funds lost to fraud or other questionable activity.

#### 12. SUBSEQUENT EVENT

On May 18, 2006, the Board approved authorization for a real estate allocation in the Montana State Fund portfolio for the cost of a new building.

#### 13. YEAR END PORTFOLIO

The June 30, 2006 All Other Funds portfolio is listed below. The security type percentage is based on the fair value ratio of the specific category of securities to the total portfolio.

| <u>Security Name</u>                    | <u>Coupon</u> | <u>Maturity</u> | <u>Par</u>        | <u>Book Value</u> | <u>Fair Value</u> | <u>%</u>     |
|-----------------------------------------|---------------|-----------------|-------------------|-------------------|-------------------|--------------|
| US BANK SWEEP REPURCHASE AGREEMENT      | 5.25          | 07/03/06        | 18,642,905        | 18,642,905        | 18,642,905        | 1.26%        |
| <b>Cash Equivalents</b>                 |               |                 | <b>18,642,905</b> | <b>18,642,905</b> | <b>18,642,905</b> | <b>1.26%</b> |
| AA / FT WORTH HQ FINANCE TRUST          | 5.50          | 10/05/10        | 8,695,227         | 8,695,227         | 8,465,151         | 0.57%        |
| ABBOTT LABS                             | 3.50          | 02/17/09        | 10,000,000        | 9,972,223         | 9,503,875         | 0.64%        |
| AMERICAN GENERAL FINANCE CORP           | 4.88          | 05/15/10        | 5,000,000         | 4,999,459         | 4,832,847         | 0.33%        |
| ARIA CDO II                             | VAR           | 10/10/12        | 10,000,000        | 10,000,000        | 9,949,900         | 0.67%        |
| B J SERVICES                            | 5.75          | 06/01/11        | 5,000,000         | 4,993,533         | 4,953,635         | 0.34%        |
| BANK AMERICA CORP                       | 3.38          | 02/17/09        | 5,000,000         | 4,986,320         | 4,736,812         | 0.32%        |
| BANK AMERICA CORP                       | 5.38          | 06/15/14        | 5,000,000         | 4,963,586         | 4,836,726         | 0.33%        |
| BANK ONE CORP                           | 6.25          | 02/15/08        | 2,000,000         | 1,973,428         | 2,020,118         | 0.14%        |
| BANKBOSTON NA                           | 6.38          | 03/25/08        | 2,000,000         | 1,973,987         | 2,025,395         | 0.14%        |
| BORG WARNER AUTOMOTIVE INC              | 7.00          | 11/01/06        | 4,000,000         | 4,005,034         | 4,020,313         | 0.27%        |
| BURLINGTON NORTHERN RR CO EQUIPMENT TR  | 6.94          | 01/02/14        | 2,962,735         | 2,962,735         | 3,122,528         | 0.21%        |
| BURLINGTON NORTHN SANTA FE EQUIPMENT TR | 7.16          | 01/02/20        | 4,147,983         | 4,147,983         | 4,392,411         | 0.30%        |
| CIT GROUP EQUIPMENT TRUST               | 6.49          | 01/05/21        | 6,861,082         | 6,861,082         | 7,102,596         | 0.48%        |
| CIT GROUP INC                           | 5.20          | 11/03/10        | 5,000,000         | 4,999,088         | 4,882,998         | 0.33%        |
| CIT GROUP INC                           | 5.75          | 09/25/07        | 5,000,000         | 5,052,769         | 5,010,334         | 0.34%        |
| CSX CORP                                | 7.45          | 05/01/07        | 5,000,000         | 4,999,371         | 5,074,298         | 0.34%        |
| CENTEX CORP                             | 5.70          | 05/15/14        | 3,000,000         | 2,996,750         | 2,785,913         | 0.19%        |
| CITIGROUP INC                           | 6.00          | 02/21/12        | 5,000,000         | 4,998,956         | 5,055,831         | 0.34%        |
| CITIGROUP INC                           | 3.63          | 02/09/09        | 5,000,000         | 4,993,734         | 4,760,660         | 0.32%        |
| COMCAST CORP                            | 5.45          | 11/15/10        | 5,000,000         | 5,009,301         | 4,919,870         | 0.33%        |
| COMMERCIAL MORTGAGE TRUST               | 5.54          | 06/10/46        | 12,000,000        | 12,029,179        | 11,958,523        | 0.81%        |
| CONTINENTAL AIRLINES EQUIPMENT TRUST    | 6.56          | 08/15/13        | 5,000,000         | 5,015,893         | 5,088,941         | 0.34%        |
| COUNTRYWIDE HOME LOANS INC              | 2.88          | 02/15/07        | 8,000,000         | 7,997,668         | 7,862,660         | 0.53%        |
| DETROIT EDISON CO                       | 5.20          | 10/15/12        | 5,000,000         | 4,956,412         | 4,826,014         | 0.33%        |
| DONNELLEY R R + SONS CO                 | 4.95          | 04/01/14        | 5,000,000         | 4,838,107         | 4,501,655         | 0.30%        |
| ENTERGY ARKANSAS INC                    | 4.50          | 06/01/10        | 3,000,000         | 2,989,596         | 2,858,711         | 0.19%        |
| FIRST CHICAGO CORP                      | 6.38          | 01/30/09        | 2,000,000         | 1,950,180         | 2,036,850         | 0.14%        |
| FORD MOTOR CREDIT                       | 5.80          | 01/12/09        | 5,000,000         | 5,044,893         | 4,567,850         | 0.31%        |
| FORD MOTOR CREDIT                       | 5.70          | 01/15/10        | 5,000,000         | 4,976,255         | 4,374,571         | 0.30%        |
| FORTUNE BRANDS INC                      | 5.38          | 01/15/16        | 5,000,000         | 4,968,175         | 4,625,130         | 0.31%        |
| GALENA CDO I                            | VAR           | 01/11/13        | 4,000,000         | 4,000,000         | 3,997,200         | 0.27%        |
| GENERAL ELECTRIC CAPITAL CORP           | 4.38          | 11/21/11        | 10,000,000        | 9,727,139         | 9,406,476         | 0.64%        |
| GENERAL ELECTRIC CAPITAL CORP           | 5.38          | 03/15/07        | 10,000,000        | 10,044,932        | 9,994,716         | 0.68%        |
| GENERAL MOTORS ACCEPTANCE CORP          | 6.13          | 08/28/07        | 5,000,000         | 5,002,122         | 4,937,906         | 0.33%        |
| GENERAL MOTORS ACCEPTANCE CORP          | 5.63          | 05/15/09        | 5,000,000         | 5,003,648         | 4,737,590         | 0.32%        |
| GOLDMAN SACHS GROUP INC                 | 5.35          | 01/15/16        | 5,000,000         | 4,945,277         | 4,697,473         | 0.32%        |
| GOLDMAN SACHS GROUP INC                 | 3.88          | 01/15/09        | 5,000,000         | 5,028,814         | 4,786,975         | 0.32%        |
| HSBC FINANCE CORP                       | 5.50          | 01/19/16        | 5,000,000         | 5,008,624         | 4,761,840         | 0.32%        |
| HOUSEHOLD FINANCE CORP                  | 4.75          | 05/15/09        | 1,000,000         | 999,503           | 973,361           | 0.07%        |
| IBP FINANCE CO                          | 7.45          | 06/01/07        | 4,000,000         | 3,999,747         | 4,043,508         | 0.27%        |
| ING SECURITY LIFE INSTITUTIONAL FUND    | 4.25          | 01/15/10        | 3,000,000         | 2,995,352         | 2,875,878         | 0.19%        |
| INTERNATIONAL LEASE FINANCE CORP        | 5.13          | 11/01/10        | 5,000,000         | 4,982,869         | 4,858,117         | 0.33%        |
| INTERNATIONAL LEASE FINANCE CORP        | 4.55          | 10/15/09        | 5,000,000         | 5,086,002         | 4,817,620         | 0.33%        |
| J P MORGAN CHASE + CO                   | 5.35          | 03/01/07        | 5,000,000         | 4,996,664         | 4,994,339         | 0.34%        |
| J P MORGAN CHASE + CO                   | 3.50          | 03/15/09        | 10,000,000        | 9,967,858         | 9,461,889         | 0.64%        |
| J P MORGAN CHASE COMMERCIAL MORTGAGE TR | 4.20          | 07/12/35        | 18,319,479        | 18,401,037        | 17,504,753        | 1.19%        |
| J P MORGAN CHASE COMMERCIAL MORTGAGE TR | 3.05          | 01/15/38        | 2,291,397         | 2,294,380         | 2,177,414         | 0.15%        |
| KCT INTERMODAL EQUIPMENT TRUST          | 6.88          | 08/01/18        | 3,317,333         | 3,317,333         | 3,430,195         | 0.23%        |
| KEY BANK                                | 4.41          | 03/18/08        | 5,000,000         | 5,000,000         | 4,906,025         | 0.33%        |
| KEYBANK NATL ASSN MTN                   | 5.45          | 03/03/16        | 5,000,000         | 4,998,839         | 4,780,155         | 0.32%        |
| KRAFT FOODS INC                         | 4.13          | 11/12/09        | 3,000,000         | 2,990,159         | 2,851,455         | 0.19%        |
| LEHMAN BROTHERS HOLDINGS INC            | 5.00          | 01/14/11        | 5,000,000         | 4,980,014         | 4,859,818         | 0.33%        |
| LEHMAN BROTHERS HOLDINGS INC            | 3.95          | 11/10/09        | 3,000,000         | 2,995,980         | 2,835,486         | 0.19%        |
| MARSH + MCLENNAN COS INC                | 7.13          | 06/15/09        | 3,000,000         | 2,997,800         | 3,091,757         | 0.21%        |
| MERRILL LYNCH + CO INC                  | 4.13          | 01/15/09        | 5,000,000         | 4,998,509         | 4,827,668         | 0.33%        |

| <u>Security Name</u>                 | <u>Coupon</u> | <u>Maturity</u> | <u>Par</u>         | <u>Book Value</u>  | <u>Fair Value</u>  | <u>%</u>      |
|--------------------------------------|---------------|-----------------|--------------------|--------------------|--------------------|---------------|
| METLIFE INC                          | 5.00          | 11/24/13        | 5,000,000          | 4,964,446          | 4,703,825          | 0.32%         |
| MORGAN STANLEY                       | 4.00          | 01/15/10        | 5,000,000          | 4,971,587          | 4,725,451          | 0.32%         |
| MORGAN STANLEY                       | 5.05          | 01/21/11        | 5,000,000          | 4,988,324          | 4,853,430          | 0.33%         |
| NATIONWIDE FINANCIAL SERVICES INC    | 6.25          | 11/15/11        | 5,000,000          | 5,220,776          | 5,087,210          | 0.34%         |
| OLD REPUBLIC INTERNATIONAL CORP      | 7.00          | 06/15/07        | 3,000,000          | 2,999,845          | 3,038,877          | 0.21%         |
| PNC FUNDING CORP                     | 4.20          | 03/10/08        | 5,000,000          | 4,998,675          | 4,876,080          | 0.33%         |
| PPL MONTANA LLC                      | 8.90          | 07/02/20        | 3,915,104          | 3,915,104          | 4,371,248          | 0.30%         |
| PANAMERICAN BEVERAGES INC            | 7.25          | 07/01/09        | 2,000,000          | 1,981,791          | 2,160,000          | 0.15%         |
| ALTRIA GROUP INC                     | 7.65          | 07/01/08        | 5,000,000          | 5,243,764          | 5,165,932          | 0.35%         |
| PRINCIPAL LIFE GLOBAL FUNDING        | 5.13          | 10/15/13        | 5,000,000          | 4,994,642          | 4,773,854          | 0.32%         |
| PRUDENTIAL FINANCIAL INC             | 5.50          | 03/15/16        | 5,000,000          | 4,900,474          | 4,806,330          | 0.33%         |
| SBC COMMUNICATIONS INC               | 5.30          | 11/15/10        | 5,000,000          | 4,990,505          | 4,869,511          | 0.33%         |
| SLM CORP                             | 4.50          | 07/26/10        | 5,000,000          | 4,988,610          | 4,774,259          | 0.32%         |
| ST PAUL TRAVELERS COS INC            | 6.25          | 06/20/16        | 5,000,000          | 4,982,453          | 5,043,533          | 0.34%         |
| SOUTHWEST GAS CORP                   | 8.38          | 02/15/11        | 4,000,000          | 3,997,174          | 4,357,430          | 0.30%         |
| UNION BANK CALIFORNIA                | 5.95          | 05/11/16        | 5,000,000          | 5,004,214          | 4,911,454          | 0.33%         |
| VERIZON COMMUNICATIONS INC           | 5.35          | 02/15/11        | 2,000,000          | 1,995,909          | 1,946,957          | 0.13%         |
| VERIZON COMMUNICATIONS INC           | 5.55          | 02/15/16        | 5,000,000          | 4,961,441          | 4,688,195          | 0.32%         |
| WACHOVIA CORP                        | 4.95          | 11/01/06        | 3,000,000          | 2,999,557          | 2,997,315          | 0.20%         |
| WASHINGTON MUTUAL INC                | 4.20          | 01/15/10        | 5,000,000          | 4,994,655          | 4,755,940          | 0.32%         |
| WELLS FARGO + CO                     | 4.63          | 04/15/14        | 5,000,000          | 4,832,309          | 4,612,259          | 0.31%         |
| WESTERN PROPERTIES REIT              | 7.20          | 09/15/08        | 1,000,000          | 986,939            | 1,027,875          | 0.07%         |
| WYETH                                | 5.50          | 02/01/14        | 5,000,000          | 4,992,658          | 4,857,711          | 0.33%         |
| ZIONS BANCORPORATION                 | 5.65          | 05/15/14        | 3,000,000          | 2,996,934          | 2,906,022          | 0.20%         |
| <b>Corporate Bonds Rated</b>         |               |                 | <b>395,510,340</b> | <b>395,016,309</b> | <b>386,073,420</b> | <b>26.15%</b> |
| ENSCO OFFSHORE CO XI USGG            | 6.36          | 12/01/15        | 9,500,290          | 9,500,290          | 9,760,503          | 0.66%         |
| GLOBAL INDUSTRIES LTD XI USGG        | 7.71          | 02/15/25        | 3,800,000          | 3,800,000          | 3,736,920          | 0.25%         |
| MAYBANK NAVIGATION LLC XI USGG       | 7.62          | 07/25/20        | 3,625,000          | 3,625,000          | 3,471,336          | 0.24%         |
| MAYBANK NAVIGATION LLC XI USGG       | 5.90          | 09/16/13        | 1,990,000          | 1,990,000          | 1,931,892          | 0.13%         |
| ROWAN COS INC XI USGG                | 5.88          | 03/15/12        | 13,635,000         | 13,635,000         | 13,704,402         | 0.93%         |
| TRICO MARINE INTERNATIONAL XI USGG   | 6.08          | 09/01/06        | 625,000            | 625,000            | 625,000            | 0.04%         |
| UNITED STATES TREASURY NOTES         | 3.00          | 02/15/09        | 2,000,000          | 1,961,023          | 1,896,094          | 0.13%         |
| UNITED STATES TREASURY NOTES         | 3.00          | 12/31/06        | 8,000,000          | 7,990,831          | 7,910,625          | 0.54%         |
| UNITED STATES TREASURY NOTES         | 4.00          | 02/15/15        | 20,000,000         | 18,762,505         | 18,431,250         | 1.25%         |
| UNITED STATES TREASURY STRIP         | -             | 11/15/17        | 2,200,000          | 1,242,038          | 1,214,822          | 0.08%         |
| <b>U.S. Government Direct-Backed</b> |               |                 | <b>65,375,290</b>  | <b>63,131,686</b>  | <b>62,682,844</b>  | <b>4.25%</b>  |
| FEDERAL HOME LOAN MORTGAGE CORP      | 5.13          | 05/13/13        | 20,000,000         | 20,000,000         | 19,229,084         | 1.30%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 4.00          | 07/18/18        | 5,000,000          | 5,000,000          | 4,726,173          | 0.32%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 3.05          | 01/19/07        | 5,000,000          | 4,980,533          | 4,931,445          | 0.33%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 2.85          | 02/23/07        | 20,000,000         | 19,993,815         | 19,649,488         | 1.33%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 3.63          | 02/15/07        | 10,000,000         | 9,992,119          | 9,878,265          | 0.67%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 4.05          | 06/28/07        | 15,000,000         | 15,000,000         | 14,781,516         | 1.00%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 4.63          | 08/15/08        | 10,000,000         | 9,968,676          | 9,855,023          | 0.67%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 4.13          | 04/02/07        | 15,000,000         | 14,937,881         | 14,837,924         | 1.01%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 5.63          | 03/15/11        | 10,000,000         | 10,043,782         | 10,059,851         | 0.68%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 6.00          | 06/15/11        | 15,000,000         | 14,993,411         | 15,334,062         | 1.04%         |
| FEDERAL HOME LOAN MORTGAGE CORP      | 3.63          | 09/15/08        | 14,000,000         | 14,031,870         | 13,480,722         | 0.91%         |
| FEDERAL HOME LOAN PC POOL E00247     | 5.50          | 10/01/08        | 112,392            | 111,775            | 111,557            | 0.01%         |
| FEDERAL HOME LOAN PC POOL E00540     | 6.00          | 03/01/13        | 1,203,960          | 1,201,368          | 1,206,923          | 0.08%         |
| FEDERAL HOME LOAN PC POOL E00659     | 6.00          | 04/01/14        | 1,278,101          | 1,277,394          | 1,281,246          | 0.09%         |
| FEDERAL HOME LOAN PC POOL G10814     | 5.50          | 05/01/13        | 1,933,357          | 1,932,363          | 1,901,110          | 0.13%         |
| FEDERAL HOME LOAN PC POOL G10173     | 6.00          | 01/01/09        | 150,583            | 150,370            | 150,883            | 0.01%         |
| FEDERAL FARM CREDIT BANKS            | 3.10          | 01/22/08        | 10,000,000         | 9,867,719          | 9,639,778          | 0.65%         |
| FEDERAL FARM CREDIT BANKS            | 4.45          | 09/23/13        | 7,000,000          | 6,758,638          | 6,549,582          | 0.44%         |
| FEDERAL HOME LOAN BANKS              | 4.00          | 12/19/11        | 8,000,000          | 7,697,911          | 7,424,210          | 0.50%         |
| FEDERAL HOME LOAN BANKS              | 4.27          | 01/17/12        | 7,000,000          | 6,796,149          | 6,569,275          | 0.44%         |
| FEDERAL HOME LOAN BANKS              | 4.15          | 06/25/13        | 12,000,000         | 11,277,968         | 10,993,592         | 0.74%         |

| <u>Security Name</u>                   | <u>Coupon</u> | <u>Maturity</u> | <u>Par</u>           | <u>Book Value</u>    | <u>Fair Value</u>    | <u>%</u>       |
|----------------------------------------|---------------|-----------------|----------------------|----------------------|----------------------|----------------|
| FEDERAL HOME LOAN BANKS                | 4.88          | 11/15/06        | 5,000,000            | 4,994,671            | 4,987,861            | 0.34%          |
| FEDERAL HOME LOAN BANKS                | 4.88          | 02/15/07        | 5,000,000            | 4,999,862            | 4,976,533            | 0.34%          |
| FEDERAL HOME LOAN BANKS                | 4.13          | 08/13/10        | 20,000,000           | 19,985,183           | 19,018,860           | 1.29%          |
| FEDERAL HOME LOAN BANKS                | 3.63          | 11/14/08        | 10,000,000           | 9,989,031            | 9,608,709            | 0.65%          |
| FEDERAL HOME LOAN BANKS                | 3.25          | 02/26/07        | 10,000,000           | 10,000,785           | 9,853,100            | 0.67%          |
| FEDERAL HOME LOAN BANKS                | 3.38          | 09/14/07        | 10,000,000           | 10,029,657           | 9,730,769            | 0.66%          |
| FEDERAL HOME LOAN BANKS                | 4.00          | 06/13/08        | 10,000,000           | 9,911,074            | 9,718,398            | 0.66%          |
| FEDERAL HOME LOAN BANKS                | 4.00          | 03/30/07        | 25,000,000           | 25,000,000           | 24,693,128           | 1.67%          |
| FEDERAL HOME LOAN BANKS                | 4.25          | 09/12/08        | 10,000,000           | 9,891,183            | 9,739,167            | 0.66%          |
| FEDERAL HOME LOAN BANKS                | 4.25          | 03/15/07        | 20,000,000           | 20,013,165           | 19,817,824           | 1.34%          |
| FEDERAL HOME LOAN BANKS                | 4.75          | 12/12/08        | 10,000,000           | 9,947,133            | 9,826,016            | 0.67%          |
| FEDERAL HOME LOAN BANKS                | 4.75          | 03/13/09        | 10,000,000           | 9,900,943            | 9,810,111            | 0.66%          |
| FEDERAL HOME LOAN BANKS                | 5.25          | 06/12/09        | 10,000,000           | 9,954,336            | 9,925,740            | 0.67%          |
| FREDDIE MAC                            | 2.88          | 05/15/07        | 10,000,000           | 9,986,956            | 9,780,502            | 0.66%          |
| FREDDIE MAC                            | 4.10          | 01/28/14        | 15,000,000           | 15,000,000           | 14,306,145           | 0.97%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 4.30          | 05/05/08        | 10,000,000           | 10,017,230           | 9,785,507            | 0.66%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 4.00          | 05/09/07        | 10,000,000           | 10,000,000           | 9,867,886            | 0.67%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 5.75          | 02/15/08        | 5,000,000            | 5,215,201            | 5,021,439            | 0.34%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 6.00          | 05/15/08        | 5,000,000            | 4,959,252            | 5,047,157            | 0.34%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 0.01          | 06/01/17        | 14,600,000           | 7,307,629            | 7,958,534            | 0.54%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 7.25          | 01/15/10        | 8,000,000            | 8,204,262            | 8,451,362            | 0.57%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 6.63          | 10/15/07        | 15,000,000           | 15,358,352           | 15,214,988           | 1.03%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 6.63          | 11/15/10        | 10,000,000           | 10,190,208           | 10,438,143           | 0.71%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 3.25          | 11/15/07        | 10,000,000           | 9,960,362            | 9,709,318            | 0.66%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 2.88          | 05/19/08        | 27,000,000           | 26,271,108           | 25,768,241           | 1.75%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 4.38          | 07/17/13        | 20,000,000           | 19,446,727           | 18,654,296           | 1.26%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 3.88          | 11/17/08        | 10,000,000           | 9,797,131            | 9,660,871            | 0.65%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 3.38          | 12/15/08        | 15,000,000           | 14,931,923           | 14,305,416           | 0.97%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 4.13          | 04/15/14        | 10,000,000           | 9,496,322            | 9,141,921            | 0.62%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 3.00          | 08/15/07        | 10,000,000           | 9,977,807            | 9,737,508            | 0.66%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 3.55          | 11/16/07        | 10,000,000           | 10,000,000           | 9,738,014            | 0.66%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 4.50          | 08/15/08        | 30,000,000           | 30,000,000           | 29,426,430           | 1.99%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 2.20          | 12/04/06        | 10,000,000           | 9,945,680            | 9,859,870            | 0.67%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 3.25          | 05/11/07        | 15,000,000           | 14,995,967           | 14,694,626           | 1.00%          |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION  | 4.30          | 03/09/09        | 10,000,000           | 9,747,475            | 9,739,808            | 0.66%          |
| FNMA POOL 190985                       | 7.50          | 08/01/09        | 347,807              | 347,808              | 353,023              | 0.02%          |
| FNMA POOL 254140                       | 5.50          | 01/01/17        | 7,263,862            | 7,240,969            | 7,144,405            | 0.48%          |
| FNMA POOL 254233                       | 5.00          | 03/01/17        | 5,567,419            | 5,422,222            | 5,383,216            | 0.36%          |
| FNMA POOL 254631                       | 5.00          | 02/01/18        | 4,495,617            | 4,516,273            | 4,339,630            | 0.29%          |
| FNMA POOL 303590                       | 7.00          | 11/01/10        | 484,063              | 484,062              | 490,786              | 0.03%          |
| FNMA POOL 313999                       | 6.00          | 02/01/13        | 652,778              | 650,629              | 655,404              | 0.04%          |
| FNMA POOL 572220                       | 6.00          | 03/01/16        | 358,479              | 357,719              | 360,202              | 0.02%          |
| FNMA POOL 592327                       | 5.50          | 06/01/16        | 715,790              | 703,320              | 704,130              | 0.05%          |
| <b>U.S. Government Indirect-Backed</b> |               |                 | <b>642,164,208</b>   | <b>631,163,360</b>   | <b>620,036,700</b>   | <b>42.00%</b>  |
| S&P 500 INDEX BGI FUND B               | NA            | NA              | 480,587              | 68,406,676           | 83,377,362           | 5.65%          |
| <b>Equity Index Fund</b>               |               |                 | <b>480,587</b>       | <b>68,406,676</b>    | <b>83,377,362</b>    | <b>5.65%</b>   |
| MONTANA RESIDENTIAL MORTGAGES          | NA            | NA              | 80,750,505           | 80,750,504           | 79,808,901           | 5.41%          |
| MONTANA PERMANENT COAL TAX TRUST LOANS | NA            | NA              | 208,928,654          | 208,928,654          | 208,928,654          | 14.15%         |
| <b>Mortgages/Loans</b>                 |               |                 | <b>289,679,158</b>   | <b>289,679,158</b>   | <b>288,737,555</b>   | <b>19.56%</b>  |
| 2273 BOOT HILL COURT, BOZEMAN MONTANA  | NA            | NA              | 2,073,887            | 2,073,887            | 2,082,014            | 0.14%          |
| CALIFORNIA STREET, HELENA MONTANA      | NA            | NA              | 204,835              | 204,835              | 213,603              | 0.01%          |
| 2401 COLONIAL DRIVE, HELENA MONTANA    | NA            | NA              | 7,183,851            | 7,183,851            | 7,676,250            | 0.52%          |
| 1712 NINTH AVENUE, HELENA MONTANA      | NA            | NA              | 514,569              | 514,569              | 579,626              | 0.04%          |
| 100 NORTH PARK AVENUE, HELENA MONTANA  | NA            | NA              | 6,500,208            | 6,500,208            | 6,141,593            | 0.42%          |
| <b>Real Estate</b>                     |               |                 | <b>16,477,350</b>    | <b>16,477,350</b>    | <b>16,693,086</b>    | <b>1.13%</b>   |
| <b>Total All Other Funds</b>           |               |                 | <b>1,428,329,840</b> | <b>1,482,517,445</b> | <b>1,476,243,872</b> | <b>100.00%</b> |

# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
Tori Hunthausen,  
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:  
James Gillett  
Jim Pellegrini

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Assets of the Enterprise Fund of the state of Montana Board of Investments as of June 30, 2006, and 2005, and the related Statement of Revenues, Expenses, and Changes in Fund Net Assets and Statement of Cash Flows for the fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Enterprise Fund of the Montana Board of Investments and are not intended to present fairly the financial position of the state of Montana as of June 30, 2006, and 2005, and the results of operations and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the state of Montana Board of Investments' Enterprise Fund as of June 30, 2006, and 2005, and the results of its operations and cash flows for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA  
Deputy Legislative Auditor

November 14, 2006



STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND  
STATEMENT OF NET ASSETS AS OF JUNE 30, 2006 AND 2005

Assets

|                                                             | <u>2006</u>          | <u>2005</u>          |
|-------------------------------------------------------------|----------------------|----------------------|
| Current assets:                                             |                      |                      |
| Cash and cash equivalents (Note 1)                          | \$ 11,242,417        | \$ 17,150,825        |
| Interest receivable                                         | 1,013,345            | 837,279              |
| Notes/loans receivable (Note 1)                             | 8,289,836            | 9,472,930            |
| Interfund notes/loans and interest receivable (Note 1)      | 4,184,376            | 3,695,207            |
| Component Unit notes/loans and interest receivable (Note 1) | 1,719,797            | 1,661,436            |
| Short-term investments at fair value (Notes 1 and 2)        | 1,517,934            | 1,806,558            |
| Security lending cash collateral (Note 3)                   | 3,172                | 0                    |
| Prepaid expenses                                            | <u>25</u>            | <u>23</u>            |
| Total current assets                                        | <u>27,970,902</u>    | <u>34,624,258</u>    |
| Noncurrent assets:                                          |                      |                      |
| Restricted investments at fair value (Notes 1 and 2)        | 4,598,906            | 4,073,621            |
| Notes/loans receivable (Note 1)                             | 36,840,193           | 34,081,800           |
| Interfund notes/loans and interest receivable (Note 1)      | 16,131,846           | 14,012,262           |
| Component Unit notes/loans receivable (Note 1)              | 6,575,176            | 6,644,152            |
| Investments at fair value (Notes 1 and 2)                   | 0                    | 17,910               |
| Capitalized cost of issue (Note 1)                          | 1,299,044            | 1,392,790            |
| Equipment                                                   | 2,990                | 2,990                |
| Accumulated depreciation                                    | <u>(2,930)</u>       | <u>(2,686)</u>       |
| Total noncurrent assets                                     | <u>65,445,225</u>    | <u>60,222,839</u>    |
| Total assets                                                | \$ <u>93,416,127</u> | \$ <u>94,847,097</u> |
| Liabilities                                                 |                      |                      |
| Current liabilities:                                        |                      |                      |
| Advances                                                    | \$ 0                 | \$ 415,450           |
| Due to other funds                                          | 3,818                | 2,855                |
| Accrued expenses                                            | 24,224               | 10,773               |
| Accrued interest payable                                    | 1,152,351            | 904,426              |
| Security lending obligations (Note 3)                       | 3,172                | 0                    |
| Arbitrage rebate tax payable                                | 35,493               | 0                    |
| Compensated absences                                        | 17,297               | 19,312               |
| Current bonds/notes payable (Note 4)                        | <u>84,558,615</u>    | <u>85,753,517</u>    |
| Total current liabilities                                   | <u>85,794,970</u>    | <u>87,106,333</u>    |
| Noncurrent liabilities                                      |                      |                      |
| Bonds/notes payable (Note 4)                                | 2,147,858            | 2,434,753            |
| Compensated absences                                        | 25,247               | 23,509               |
| Arbitrage rebate tax payable                                | <u>93,750</u>        | <u>114,154</u>       |
| Total noncurrent liabilities                                | <u>2,266,855</u>     | <u>2,572,416</u>     |
| Total liabilities                                           | \$ <u>88,061,825</u> | \$ <u>89,678,749</u> |
| Net Assets                                                  |                      |                      |
| Invested in capital assets, net of related debt             | \$ 60                | \$ 304               |
| Restricted (Note 1)                                         | 2,920,959            | 2,504,067            |
| Unrestricted                                                | <u>2,433,283</u>     | <u>2,663,977</u>     |
| Total net assets (Note 7)                                   | \$ <u>5,354,302</u>  | \$ <u>5,168,348</u>  |
| Total liabilities and net assets                            | \$ <u>93,416,127</u> | \$ <u>94,847,097</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2005

| Operating revenue                       | <u>2006</u>         | <u>2005</u>         |
|-----------------------------------------|---------------------|---------------------|
| Reimbursements                          | \$ 6,794            | \$ 4,671            |
| Investment income                       | 570,079             | 636,922             |
| Security lending income                 | 259                 | 0                   |
| Financing income                        | <u>3,049,576</u>    | <u>2,125,548</u>    |
| Total operating revenue                 | <u>3,626,708</u>    | <u>2,767,141</u>    |
| Operating expenses                      |                     |                     |
| Personal services                       | 249,637             | 252,489             |
| Contracted services                     | 21,890              | 31,059              |
| Supplies and materials                  | 10,382              | 3,406               |
| Communications                          | 6,152               | 6,359               |
| Travel                                  | 2,789               | 4,299               |
| Rent                                    | 41,103              | 40,243              |
| Repair and maintenance                  | 1,072               | 288                 |
| Indirect and other costs                | 38,294              | 29,872              |
| Depreciation expense                    | 244                 | 913                 |
| Arbitrage rebate tax expense            | 3,600               | 66,646              |
| Security lending expense                | 258                 | 0                   |
| Debt service                            |                     |                     |
| Interest expense                        | 2,709,327           | 1,824,510           |
| Trustee fee expense                     | 70,888              | 61,628              |
| Bond issuance cost amortization expense | 93,746              | 114,903             |
| Other debt service expense              | <u>191,372</u>      | <u>189,786</u>      |
| Total operating expenses                | <u>3,440,754</u>    | <u>2,626,401</u>    |
| Operating income                        | <u>185,954</u>      | <u>140,740</u>      |
| Nonoperating (expense):                 |                     |                     |
| Loss on disposal of fixed assets        | <u>0</u>            | <u>(2,945)</u>      |
| Change in net assets                    | 185,954             | 137,795             |
| Beginning net assets                    | <u>5,168,348</u>    | <u>5,030,553</u>    |
| Ending net assets (Note 7)              | \$ <u>5,354,302</u> | \$ <u>5,168,348</u> |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND  
STATEMENT OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

|                                                                                 | <u>2006</u>         |    | <u>2005</u>         |
|---------------------------------------------------------------------------------|---------------------|----|---------------------|
| Cash flows from operating activities:                                           |                     |    |                     |
| Receipts for sales and services                                                 | \$ 6,794            | \$ | 4,671               |
| Payments to suppliers for goods and services                                    | (108,356)           |    | (118,993)           |
| Payments to employees                                                           | <u>(248,828)</u>    |    | <u>(238,308)</u>    |
| Net cash (used for) operating activities                                        | <u>(350,390)</u>    |    | <u>(352,630)</u>    |
| Cash flows from non-capital financing activities:                               |                     |    |                     |
| Payment of principal and interest on bonds and notes                            | (5,308,863)         |    | (10,616,278)        |
| Proceeds from issuance of bonds and notes                                       | 1,103,404           |    | 176,996             |
| Payment of bond issue costs                                                     | <u>0</u>            |    | <u>0</u>            |
| Net cash (used for) provided by non-capital financing activities                | <u>(4,205,459)</u>  |    | <u>(10,439,282)</u> |
| Cash flows from investing activities:                                           |                     |    |                     |
| Collections for principal and interest on loans                                 | 20,807,207          |    | 20,285,591          |
| Cash payments for loans                                                         | (22,518,931)        |    | (22,370,759)        |
| Purchase of investments                                                         | (2,146,092)         |    | (1,333,514)         |
| Proceeds from security lending                                                  | 259                 |    | 0                   |
| Security lending costs                                                          | (258)               |    | 0                   |
| Proceeds from sales or maturities of investments                                | 1,793,553           |    | 23,226,880          |
| Interest on investments                                                         | 700,215             |    | 691,858             |
| Refund from (payment for) arbitrage rebate tax                                  | <u>11,488</u>       |    | <u>(92,027)</u>     |
| Net cash (used for) provided by investing activities                            | <u>(1,352,559)</u>  |    | <u>20,408,029</u>   |
| Net (decrease) increase in cash and cash equivalents                            | (5,908,408)         |    | 9,616,117           |
| Cash and cash equivalents, July 1                                               | <u>17,150,825</u>   |    | <u>7,534,708</u>    |
| Cash and cash equivalents, June 30                                              | <u>11,242,417</u>   |    | <u>17,150,825</u>   |
| Reconciliation of net income to net cash (used for) operating activities:       |                     |    |                     |
| Net operating income                                                            | 185,954             |    | 140,740             |
| Adjustments to reconcile net income to net cash (used for) operating activities |                     |    |                     |
| Depreciation                                                                    | 244                 |    | 913                 |
| Interest on investments                                                         | (570,079)           |    | (636,922)           |
| Financing income                                                                | (3,049,576)         |    | (2,125,548)         |
| Interest expense                                                                | 3,065,333           |    | 2,190,827           |
| Security lending income                                                         | (259)               |    | 0                   |
| Security lending expense                                                        | 258                 |    | 0                   |
| Arbitrage rebate tax expense                                                    | 3,600               |    | 66,646              |
| Change in assets and liabilities:                                               |                     |    |                     |
| Increase (decrease) in other assets                                             | (2)                 |    | (5)                 |
| Increase (decrease) in other payables                                           | 13,451              |    | (3,921)             |
| Increase (decrease) in due to other funds                                       | 963                 |    | (3,229)             |
| Increase (decrease) in compensated absences payable                             | <u>(277)</u>        |    | <u>17,869</u>       |
| Total adjustments                                                               | <u>(536,344)</u>    |    | <u>(493,370)</u>    |
| Net cash (used for) operating activities                                        | \$ <u>(350,390)</u> | \$ | <u>(352,630)</u>    |
| Schedule of noncash transactions:                                               |                     |    |                     |
| Increase/decrease in fair value of investments                                  | \$ <u>105,458</u>   | \$ | <u>(8,574)</u>      |
| Total noncash transactions                                                      | \$ <u>105,458</u>   | \$ | <u>(8,574)</u>      |

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND

NOTES TO FINANCIAL STATEMENTS  
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Accounting

The Board uses the accrual basis of accounting for the Enterprise Fund. Under the accrual basis of accounting, expenses are recorded when incurred and revenues are recorded when earned. The financial statements are prepared from the Statewide Accounting, Budgeting, and Human Resource System (SABHRS) and information contained in the bond trustee statements. The statements include the financial activity administered by the Board in the Enterprise Fund.

b. Presentation of Programs

The Board uses the Enterprise Fund to account for its programs created under the Economic Development Bond Act and the Municipal Finance Consolidation Act.

Economic Development Bond Act programs include:

- The Stand Alone Economic Development Bond Program provides access to limited economic development projects through the issuance of conduit debt.
- The Conservation Reserve Enhancement Program (CRP), created in 1990 by issuing bonds, allows farmers to receive a lump sum payment by assigning their federal CRP contract to the Board. The farmers under contract must comply with seeding and other requirements. The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.
- The Family Friendly Business Loan Program provided zero interest loans to qualified business owners who hire participants of the Families Achieving Independence in Montana (FAIM) employment and training component. The Department of Health and Human Services pays the interest on the loans. As of June 30, 2006, all loans are paid in full and the program is inactive.

Municipal Finance Consolidation Act programs include:

- The INTERCAP loan program provides funds to eligible Montana governments to finance capital expenditures for up to ten years.
- The Irrigation District Pooled Loan Program provided funds for the Board to purchase the refunding bonds from participating irrigation districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans.

c. Fixed Asset Depreciation

The equipment fixed assets recorded in the Enterprise Fund are depreciated on a straight-line basis, with salvage value, in accordance with state policy.

d. Receivables

The Enterprise Fund notes/loans receivables of \$73,247,245 as of June 30, 2006, and \$69,225,770 as of June 30, 2005, represent loans made to Montana businesses, state and local governments. The Enterprise Fund notes/loans are classified in three categories as follows:

- 1) Notes/loans receivable from local governments and Montana businesses
- 2) Interfund notes/loans receivable from state agency governments
- 3) Component Unit notes/loans receivable from certain state agencies and university units for which the State is financially accountable.

In May 2006, the Enterprise Fund wrote off a \$37,223 loan principal balance for the Meadowlark Mulch loan. The Family Friendly Business Loan Program funded \$39,936 for this loan in January 1999.

The InterFund notes/loans receivable as of June 30, 2006 and 2005 includes \$493,979 and \$342,007, respectively, in interest accruals from state agencies and university units.

e. Capitalized Cost of Issue

The Enterprise Fund capitalized cost of issue asset of \$1,299,044 and \$1,392,790 as of June 30, 2006 and June 30, 2005, respectively, represents paid bond issuance costs which have been capitalized and are being amortized, using the straight-line method, over the life of the bonds.

f. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Enterprise Fund considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents, as identified in the Statement of Net Assets, are as follows:

|                                         |    | <u>June 30, 2006</u> | <u>June 30, 2005</u> |
|-----------------------------------------|----|----------------------|----------------------|
| Cash in treasury                        | \$ | 24,092               | \$ 19,787            |
| Cash with fiscal agent                  |    | 2,110                | 0                    |
| Short Term Investment Pool (STIP)       |    | 193,429              | 196,544              |
| First American Treasury Obligation Fund |    | <u>11,022,786</u>    | <u>16,934,494</u>    |
| Total Cash and Cash Equivalents         | \$ | <u>11,242,417</u>    | <u>\$ 17,150,825</u> |

The Enterprise Fund invests its operational cash in the Board's Short Term Investment Pool (STIP), an external investment pool. An external investment pool commingles the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. STIP participants include both state agencies and local governments. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values.

g. Restricted Net Assets

The Statement of Net Assets for the Enterprise Fund reports restricted assets. Net assets are reported as restricted when constraints placed on net asset use are either:

- a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or
- b. Imposed by law through constitutional provisions or enabling legislation.

The net assets of all Enterprise Fund programs with the exception of MEDB (Montana Economic Development Bonds) Guarantee Fund Account, MEDB Guarantee CRP Note Reserve, MEDB Contingency Account, MEDB Family Friendly Account and CRP are restricted under bond indentures governing the use of these funds.

h. Investments

Investments are presented in the Statement of Net Assets at fair value. Investment fair values for publicly traded securities are determined primarily by reference to market prices supplied to the Board's trustee. Amortized cost, or carrying value, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line method to the maturity date of the securities.

2. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the Board implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

The Enterprise Fund deposits and investments are restricted by the bond trust indentures to the following: government and agency obligations, certificates of deposits, repurchase agreements, and investment agreements. Deposits and investments must be made with Montana banks or in the Short Term Investment Pool (STIP) administered by the Board.

Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Enterprise Fund's U.S. government direct-backed securities, consisting of U.S. Treasury notes and bills, are guaranteed directly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the table below are provided by S&P's rating services.

### Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006 and 2005, Enterprise Fund securities were recorded in book entry form in the name of U.S. Bank National Association as Trustee for the Montana Board of Investments by specific account.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Enterprise Fund investments represent investments directly issued or explicitly guaranteed by the U.S. government and investments in mutual funds. These investments are excluded from the concentration of credit risk requirement.

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Enterprise Funds' bond indentures do not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the duration method to disclose interest rate risk.

State of Montana Enterprise Fund investments are categorized below to disclose credit and interest rate risk as of June 30, 2006 and June 30, 2005. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using duration as calculated by Board staff. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

#### Credit Quality Rating and Effective Duration as of June 30, 2006

| <u>Security Investment Type</u>               |    | <u>Fair Value</u> | <u>Credit<br/>Quality<br/>Rating</u> | <u>Effective<br/>Duration</u> |
|-----------------------------------------------|----|-------------------|--------------------------------------|-------------------------------|
| First American Treasury Obligation Fund       | \$ | 11,022,786        | AAA                                  | NA                            |
| Short Term Investment Pool (STIP)             |    | 193,429           | NR                                   | NA                            |
| U.S. Government Direct-Backed                 |    | <u>6,116,840</u>  | <u>AAA</u>                           | <u>2.15</u>                   |
| Total Investments                             | \$ | <u>17,333,055</u> | <u>AAA</u>                           | <u>2.15</u>                   |
| Securities Lending Collateral Investment Pool | \$ | <u>3,172</u>      | NR                                   | NA                            |

#### Credit Quality Rating and Effective Duration as of June 30, 2005

| <u>Security Investment Type</u>               |    | <u>Fair Value</u> | <u>Credit<br/>Quality<br/>Rating</u> | <u>Effective<br/>Duration</u> |
|-----------------------------------------------|----|-------------------|--------------------------------------|-------------------------------|
| First American Treasury Obligation Fund       | \$ | 16,934,494        | AAA                                  | NA                            |
| Short Term Investment Pool (STIP)             |    | 196,544           | NR                                   | NA                            |
| U.S. Government Direct-Backed                 |    | <u>5,898,089</u>  | <u>AAA</u>                           | <u>2.05</u>                   |
| Total Investments                             | \$ | <u>23,029,127</u> | <u>AAA</u>                           | <u>2.05</u>                   |
| Securities Lending Collateral Investment Pool | \$ | <u>0</u>          | NR                                   | NA                            |

There were no derivative transactions during the above fiscal years for investments held by the trustee.

### 3. SECURITY LENDING

The Enterprise Fund is a participant in the Board's Short Term Investment Pool (STIP). In fiscal year 2006, security lending transactions were recorded for STIP. In fiscal year 2005, STIP had no security lending transactions.

Under the provisions of state statutes, the Board has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's STIP securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the fair value of the loaned securities and maintain collateral equal to not less than 102 percent of the fair value of the loaned securities. The

Board retains all rights and risks of ownership during the loan period.

During fiscal years 2006 and 2005, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 2006 and 2005 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2006 and 2005. Moreover, there were no losses during fiscal years 2006 and 2005 resulting from a default of the borrowers or State Street.

During fiscal years 2006 and 2005, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust which has a weighted average maturity of 56 and 35 days, respectively, as of June 30, 2006 and 2005. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. At year-end, the Board has no credit risk exposure to borrowers because the amounts the Board owes the borrowers exceed the amounts the borrowers owe the system.

#### 4. BONDS PAYABLE

##### Long-Term Bonds Payable

##### Economic Development Bonds (EDB) and Municipal Finance Consolidation Act Bonds (MFCAB)

These bonds are issued under the Economic Development Bond Act, and the Municipal Finance Consolidation Act, for the purpose of assisting Montana's small businesses and local governments in obtaining low cost financing. Outstanding obligations are listed as follows (in thousands):

##### Bonds Payable as of June 30, 2006

| <u>Program</u>                                                        | <u>Series</u> | <u>Amount<br/>Issued</u> | <u>Interest<br/>Range %</u> | <u>Principal Payments<br/>FY 2007</u> | <u>@ Maturity</u> | <u>Balance<br/>June 30, 2006</u> |
|-----------------------------------------------------------------------|---------------|--------------------------|-----------------------------|---------------------------------------|-------------------|----------------------------------|
| Municipal Finance Consolidation Act Bonds<br>(Irrigation Program) (1) | 1988          | 4,976                    | 6.60-7.75                   | 40                                    | 70 (2014)         | 430                              |
| Conservation Reserve Enhancement Program<br>(CRP Bonds) (2)           |               | 2,656                    | 6.00-7.50                   | 898                                   | 108(2011)         | 2,656                            |
| Total Bonds Payable                                                   |               | <u>\$ 7,632</u>          |                             | <u>\$ 938</u>                         |                   | <u>\$ 3,086</u>                  |
| Less Current Portion (FY2006 Principal<br>Payments)                   |               |                          |                             |                                       |                   | (938)                            |
| Total Long-Term Bonds Payable                                         |               |                          |                             |                                       |                   | <u>\$ 2,148</u>                  |

##### Bonds Payable as of June 30, 2005

| <u>Program</u>                                                        | <u>Series</u> | <u>Amount<br/>Issued</u> | <u>Interest<br/>Range %</u> | <u>Principal Payments<br/>FY 2006</u> | <u>@ Maturity</u> | <u>Balance<br/>June 30, 2005</u> |
|-----------------------------------------------------------------------|---------------|--------------------------|-----------------------------|---------------------------------------|-------------------|----------------------------------|
| Municipal Finance Consolidation Act Bonds<br>(Irrigation Program) (1) | 1988          | 4,976                    | 6.60-7.75                   | 450                                   | 70 (2014)         | 880                              |
| Conservation Reserve Enhancement Program<br>(CRP Bonds) (2)           |               | 3,028                    | 6.00-8.00                   | 1023                                  | 33 (2008)         | 3,028                            |
| Total Bonds Payable                                                   |               | <u>8,004</u>             |                             | <u>1,473</u>                          |                   | <u>3,908</u>                     |
| Less Current Portion (FY2005 Principal<br>Payments)                   |               |                          |                             |                                       |                   | <u>\$ (1,473)</u>                |
| Total Long-Term Bonds Payable                                         |               |                          |                             |                                       |                   | <u>2,435</u>                     |

(1) The Board issued these bonds to provide funds to purchase the Refunding Bonds of participating Irrigation Districts for the purpose of

prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans. The Irrigation Bonds and the interest thereon are payable solely from the collection of a special tax or assessment which is a lien against real property in the Irrigation District. While the Irrigation Bonds are not obligations of the State of Montana, the bonds are limited obligations of the Board due to an irrevocable pledge to lend money for deposit by the Trustee of the Irrigation District Pooled Loan Program Reserve Account E in an amount equal to any deficiencies therein on any payment date. The Indenture does not permit the issuance of additional bonds.

(2) The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.

Future debt service as of June 30, 2006 is listed below (in thousands):

|           | <u>2007</u>     | <u>2008</u>     | <u>2009</u>   | <u>2010</u>   | <u>2011</u>   | <u>2012-14</u> | <u>Total</u>    |
|-----------|-----------------|-----------------|---------------|---------------|---------------|----------------|-----------------|
| Principal | \$ 938          | \$ 977          | \$ 533        | \$ 280        | \$ 163        | \$ 195         | \$ 3,086        |
| Interest  | \$ 197          | \$ 138          | \$ 76         | \$ 42         | \$ 24         | \$ 24          | \$ 501          |
| Total     | <u>\$ 1,135</u> | <u>\$ 1,115</u> | <u>\$ 609</u> | <u>\$ 322</u> | <u>\$ 187</u> | <u>\$ 219</u>  | <u>\$ 3,587</u> |

Future debt service as of June 30, 2005 is listed below (in thousands):

|           | <u>2006</u>     | <u>2007</u>     | <u>2008</u>     | <u>2009</u>   | <u>2010</u>  | <u>2011-14</u> | <u>Total</u>    |
|-----------|-----------------|-----------------|-----------------|---------------|--------------|----------------|-----------------|
| Principal | \$ 1,474        | \$ 1,005        | \$ 1,051        | \$ 78         | \$ 50        | \$ 250         | \$ 3,908        |
| Interest  | \$ 251          | \$ 164          | \$ 97           | \$ 27         | \$ 21        | \$ 40          | \$ 600          |
| Total     | <u>\$ 1,725</u> | <u>\$ 1,169</u> | <u>\$ 1,148</u> | <u>\$ 105</u> | <u>\$ 71</u> | <u>\$ 290</u>  | <u>\$ 4,508</u> |

Current Bonds Payable

The Enterprise Fund is authorized to issue INTERCAP bonds under the Municipal Finance Consolidation Act. These bonds may not aggregate more than \$120 million as amended by the 2003 Legislature. The INTERCAP bonds provide funds for the Board to make loans to eligible government units. The bonds are not a debt or liability of the State of Montana. The bonds are limited obligations of the Board payable solely from: a) repayments of principal and interest on loans made by the Board to participating eligible Montana governments; b) investment income under the indenture; and c) an irrevocable pledge by the Board. The Board has no taxing power. These bonds may be redeemed, at the bondholder's option, any March 1, prior to maturity. The Board did not enter into an arms-length financing agreement to convert the bonds "put", but not resold into some other form of long-term obligation. Accordingly, these bonds, considered demand bonds, are recorded as current liabilities of the Enterprise Fund.

The INTERCAP obligations at June 30, 2006 and June 30, 2005, are listed below (in thousands):

| <u>Series</u>                              | <u>Amount Issued</u> | <u>Interest Range</u> | <u>Maturity</u> | <u>Balance June 30, 2006</u> | <u>Balance June 30, 2005</u> |
|--------------------------------------------|----------------------|-----------------------|-----------------|------------------------------|------------------------------|
| 1994                                       | 7,500                | Variable              | 2009            | 6,745                        | 6,810                        |
| 1995                                       | 7,500                | Variable              | 2010            | 6,915                        | 6,995                        |
| 1997                                       | 10,000               | Variable              | 2017            | 9,605                        | 9,690                        |
| 1998                                       | 12,500               | Variable              | 2018            | 12,200                       | 12,285                       |
| 2000                                       | 15,000               | Variable              | 2025            | 14,865                       | 15,000                       |
| 2003                                       | 15,000               | Variable              | 2028            | 14,815                       | 15,000                       |
| 2004                                       | <u>\$18,500</u>      | Variable              | 2029            | <u>18,475</u>                | <u>18,500</u>                |
| Total INTERCAP Debt                        | <u>\$86,000</u>      |                       |                 | <u>83,620</u>                | <u>84,280</u>                |
| Current Portion of Long-Term Bonds Payable |                      |                       |                 | <u>938</u>                   | <u>1,473</u>                 |
| Current Bonds Payable                      |                      |                       |                 | \$ <u>84,558</u>             | \$ <u>85,753</u>             |

## 5. OTHER DEBT

### Conduit Debt

In this program, the Board is authorized to issue stand-alone industrial revenue bonds, under the Economic Development Act, as conduit (no commitment) debt. Assets and revenues of the borrower are pledged to repay the bonds. Because the Board has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued by the Board as conduit (no-commitment) debt are listed below (in thousands):

| <u>Project</u>           | <u>Issue Date</u> | <u>Maturity Date</u> | <u>Amount<br/>Issued</u> | <u>Balance<br/>June 30, 2006</u> | <u>Balance<br/>June 30, 2005</u> |
|--------------------------|-------------------|----------------------|--------------------------|----------------------------------|----------------------------------|
| Colstrip                 | October 1989      | 12/30/15             | 60,800                   | 50,700                           | 53,100                           |
| Yellowstone Energy (BGI) | July 1993         | 12/31/19             | 118,345                  | 115,145                          | 116,345                          |
| Stillwater Mining        | July 2000         | 07/01/20             | 30,000                   | 30,000                           | 30,000                           |
| Gainey Foundation        | October 2002      | 09/01/14             | <u>6,000</u>             | <u>4,700</u>                     | <u>5,140</u>                     |
| Total conduit debt       |                   |                      | <u>\$ 215,145</u>        | <u>\$ 200,545</u>                | <u>\$ 204,585</u>                |

### QZAB Debt

In this program, the Board is authorized to issue Qualified Zone Academy Bonds (QZAB), under the Municipal Finance Consolidation Act, as conduit (no commitment) debt. The revenues, and in some cases the taxing power, of the borrower are pledged to repay the bonds. Because the Board has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued by the Board as QZAB conduit (no-commitment) debt are listed below (in thousands):

| <u>Project</u>               | <u>Issue Date</u> | <u>Maturity Date</u> | <u>Amount<br/>Issued</u> | <u>Balance<br/>June 30, 2006</u> | <u>Balance<br/>June 30, 2005</u> |
|------------------------------|-------------------|----------------------|--------------------------|----------------------------------|----------------------------------|
| Huntley Project K-12 Schools | December 2000     | 07/01/13             | \$ 750                   | \$ 750                           | \$ 750                           |
| Bozeman Public Schools       | November 2003     | 11/25/12             | 1,586                    | 1,586                            | 1,586                            |
| Philipsburg Schools          | December 2003     | 12/10/17             | 2,000                    | 2,000                            | 2,000                            |
| Cut Bank Elementary          | August 2005       | 08/18/21             | 825                      | 825                              | 0                                |
| Cut Bank High School         | August 2005       | 08/18/21             | <u>625</u>               | <u>625</u>                       | <u>0</u>                         |
| Total QZAB conduit debt      |                   |                      | <u>\$ 5,786</u>          | <u>\$ 5,786</u>                  | <u>\$ 4,336</u>                  |

## 6. INTERCAP PROGRAM LOAN COMMITMENTS

The Board makes firm commitments to fund loans from the INTERCAP loan program. As of June 30, 2006 and 2005, respectively, the Board committed to make loans to eligible Montana governments totaling \$30,929,351 and \$39,207,721.

## 7. NET ASSETS

Net Assets represents the accumulated net profits of the Enterprise Fund programs. The Net Assets for fiscal years ended June 30, 2006 and June 30, 2005 include (\$156,004) and (\$50,546), respectively, in unrealized appreciation (depreciation) in reporting the fair value of the Enterprise Fund investments.

## 8. CONSOLIDATION ACT BONDS, Series 2007

On August 24, 2006 the Board gave preliminary approval to issue a new \$15,000,000 bond, Series 2007, to provide funds for the INTERCAP Revolving Loan Program (the "Program"). Funds available to loan will be depleted by March 2007 or earlier based on the Program's historical fundings and repayments as well as large state agency loan draw projections. Finalization of the bond amount and issuance date will occur at the Board's next regular meeting. The issuance will take place in conjunction with the Program's March 2007 bond remarketing period or earlier depending on demand.



# MONTANA BOARD OF INVESTMENTS

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Helena, MT 59620-0126



November 28, 2006

Scott A. Seacat, Legislative Auditor  
Legislative Audit Division  
Room 135, State Capitol  
Helena MT 59620-1705

RECEIVED

NOV 29 2006

LEGISLATIVE AUDIT DIV.

Dear Scott:

The Board of Investments appreciates the services your staff provide in reviewing the Board's procedures, internal controls, accounting practices, and the accuracy of the financial statements. Your employees, as usual, were very considerate during the audit and maintained an excellent working relationship with Board staff. The Board is charged with managing the constitutionally-established Unified Investment Program and depends upon audit staff's thorough and objective annual review of our operations to detect any problems that Board staff may not observe.

At the end of Fiscal 2006, the Board invested \$11.45 billion of public funds and during the year managed investments for 478 individual accounts, consisting of 298 state agency accounts and 180 local government accounts. The Board's operation utilizes several different accounting systems to accurately track investments in various asset classes, which include public and private domestic and international equity, private real estate, corporate, government, and agency bonds, commercial loans, and residential mortgages. One additional financial statement was added this year for the newly-created real estate pool.

Sincerely yours,

Mr. Carroll South, Executive Director  
Montana Board of Investments





